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No. 885

Supreme Court of the United States

October Term, 1944.

A. M. ANDERSON, Receiver of the National Bank of Kentucky of Louisville, - - Petitioner,

versus

R. C. TWAY, - - - - - - - Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF IN SUPPORT OF PETITION.

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IN THE

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October Term 1944.

No. _____.

A. M. ANDERSON, RECEIVER OF THE NATIONAL BANK OF KENTUCKY OF LOUISVILLE, - *Petitioner,*

v.

R. C. TWAY, - - - - - - - - - *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

A. M. Anderson, Receiver of the National Bank of Kentucky of Louisville prays that a writ of certiorari issue to review the judgment entered June 12, 1944 (R. 1355), and the Order denying the petition for rehearing entered September 11, 1944 (R. 1463), in the United States Circuit Court of Appeals for the Sixth Circuit, in Cause No. 9250 on the docket of said Court. Said judgment affirmed, by divided vote, the judgment of the District Court of the United States for the Western District of Kentucky finding in favor of respondent and overruling the motions of petitioner for judgment and for a new trial.

OPINIONS BELOW.

The memorandum of Judge Taylor, in the District Court, is not reported, but appears in the record (R. 1296). The opinion of the Court of Appeals is unusual, in that it is the dissenting opinion of Judge Simons, with a limited and partial concurrence by Judges McAllister and Hicks and is reported in 143 Fed. 2d 95 (R. 1359).

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on June 12, 1944 (R. 1355). The petition for rehearing was denied on September 11, 1944 (R. 1463). On December 4, 1944, this Court extended the time for filing this petition for certiorari to January 31, 1945.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U. S. C., 347.

QUESTIONS PRESENTED.

1. The first question concerns the fundamental right of cross-examination inherent in due process, which was entirely denied the petitioner in the trial before a jury in the Court below, under the following circumstances:

Defendant (Tway) borrowed money from the National Bank of Kentucky and gave his note to the Bank. The purpose of the loan was to pay his subscription for BancoKentucky stock. Sued on the note by Receiver, his defense was that the Bank falsely represented the condition of the Bank and the purpose of BancoKentucky. Defendant did not call any witnesses as to the alleged falsity. He relied exclusively on reading to the jury excerpts from unsworn papers, to-wit: (a) National Bank Examiners' reports, containing hearsay and secondhand information, the accuracy of which the Examiner said he could not guarantee; (b) A Bill in Equity, filed by Receiver claiming damage for dereliction of duty against the Bank's directors; (c) A table of earnings prepared by an accountant employed by the Receiver in another case.

The District Court overruled all objections of petitioner and permitted counsel for defendant to read to the jury such unsworn documents without calling as witnesses the persons responsible therefor. The Receiver was thereby denied all opportunity for cross-examination as to the competency, truth and accuracy of the hearsay and other statements made in such documents.

The question presented is whether, in a jury trial, the admission of such documents constitute a departure from the accepted and usual course of judicial proceedings and denies the party accused of fraud his constitutional right of cross-examination and due process of law?

2. Is hearsay evidence legitimatized and made legal proof by being included in an official report?

3. After the unverified Bill in Equity against the Bank directors was read to the jury, petitioner offered in evidence the final opinions and decrees of the Court in the Directors' Liability case, wherein the Court found that certain material allegations of the Receiver's Bill in Equity, read by plaintiff to the jury, were not proved, but the Trial Judge excluded said opinions and decrees from the consideration of the jury.

Did the Trial Judge, in refusing to permit the petitioner to show that the courts had not sustained said allegations of said unverified Bill in Equity, and by such refusal making the allegations of said Bill unimpeachable proof of the truth thereof, depart from the accepted and usual course of judicial proceedings and deny the petitioner due process of law?

4. After the trial, new evidence was discovered, which the Court of Appeals described as showing that the defendant made "concededly false representations to the Receiver" and gave "concededly untrue evidence in the trial below" (R. 1371). Petitioner moved for a new trial, in order to present said evidence to the jury, which the Court denied.

Did the Court, in refusing to reopen the case in order to permit a jury to pass upon such evidence and the effect thereof on the credibility of the defendant (who was the sole witness on the material factors in the case) depart from the accepted and usual course of judicial proceedings and deny to the petitioner his right to a jury trial on the true facts?

5. The trial Court charged the jury that even if defendant in buying Banco stock participated with the Bank in *ultra vires* acts, that fact was "immaterial" (R. 1216) and not to be considered by the jury. Was the charge of the Court contrary to applicable decisions of this Court, particularly, where defendant admitted that he knew that the Bank in selling such stock was acting beyond its corporate powers?

6. Where stock acquired with money borrowed from the National Bank is retained by defendant, together with dividends thereon and said stock had both a considerable market value and intrinsic value at the time of its purchase and at all times prior to the failure of the Bank and thereafter the value which it had at the time of purchase was lost, due to independent acts of the corporation after defendant became a stockholder thereof, should petitioner be charged with said loss of value due to the independent acts of the corporation arising subsequent to defendant's acquisition of his stock therein?

SUMMARY STATEMENT AS TO QUESTIONS 1, 2 AND 3.

Officers and directors of National Bank of Kentucky caused BancoKentucky Company, a Delaware corporation, to be organized. They solicited subscriptions to its stock. Defendant, Tway, was urged by Thieman, a Bank Vice President, to buy stock. "Tway was a big operator—his monthly stock investments carried in his own name, averaging $218,000.00 in 1922, $473,000.00 in 1923, and his overdrafts with the Sales Company for that purpose reaching $461,000.00 in 1930" (R. 1370).

Tway subscribed for 2,000 shares of Banco stock at the issue price of $25.00 per share (R. 169). On October 1, 1929, he borrowed $50,000.00 from the Bank for the purpose of paying for his subscription. At the same time he gave a note, due in four months, to repay this loan (R. 130). He agreed to pledge the Banco stock as collateral security for the payment of the note (R. 84, 85). The loan was credited to Tway's personal checking and deposit account (Ex. 9, R. 86). Tway then drew his check, payable to the BancoKentucky Company, for $50,000.00 (Ex. 10, R. 88). The 2,000 shares of Banco stock were issued in the name of R. C. Tway by the Louisville Trust Company and pursuant to Tway's power of attorney were delivered to the Bank and held by the Bank as collateral to Tway's note.

Tway received the regularly quarterly dividends paid by Banco on his stock (Exs. 20, 21, 22, 23, R. 113). He renewed his note as it became due and paid

the interest accrued thereon (R. 89, 79). This continued until the close of the Bank.

After the Bank closed, Tway continued to pay interest on his note (R. 82, Ex. 1, R. 78). He also filed his affidavit with the Receiver, for the purpose of securing an offset of his deposit account and other deposit accounts, including the R. C. Tway Special Account. He swore that he owned these accounts (R. 134, 135). In this affidavit, Tway further acknowledged his indebtedness to the Bank on the note. On the faith of this affidavit, the Receiver granted Tway the offset. Tway also made a payment on account of principal, which, together with the offset, reduced the balance due on the note to $45,000.00 (Ex. 1, R. 78).

Numerous similar notes had been given to the Bank, promising to repay money borrowed for the purpose of acquiring Banco stock. At the outset, said notes aggregated approximately $4,000,000.00, but the total was materially reduced by payments thereon. When notes were not paid, the Receiver sought to enforce collection by suit. One of these suits was instituted against Dant, who asserted in his answer as a defense to his note liability that the Bank had defrauded him by misrepresenting its condition and the purposes for which BancoKentucky was formed. Other defendants copied Dant's defense on a duplicating or ditto machine, so that it became known as a "ditto defense" (R. 455, 465, 466). The present suit was brought against Tway to recover the balance due and unpaid on his note. He thereupon copied into his answer, with-

out change, the language of the Dant defense. The Tway case was the first case tried. Twenty other cases were continued, pending a determination of the law in the Tway case. Thus the present case is a type case upon the outcome of which a large number of pending suits aggregating $640,000.00 await.

The suit of the Receiver against Tway was a common-law action to recover money only on his promissory note and was tried before a jury. Tway was the sole witness as to the alleged misrepresentations. He testified that he relied exclusively on the representations of Thieman, a Bank Vice President (R. 127). Tway exonerated Thieman of any intent to misrepresent (R. 127, 348, 352). Thieman's good faith was admitted to be beyond question, since he had invested his personal and his family's fortune in Banco stock, in the firm belief that his statements to Tway, concerning said Company, were true (R. 352, 657).

The alleged misrepresentations were:

1. That the National Bank of Kentucky, to be acquired by Banco, was in good condition, whereas in fact its assets included slow, doubtful and criticised items.

2. That Banco's purposes were correctly shown in the Prospectus, whereas in truth the purpose was to acquire from the Bank its bad assets.

Tway testified to the making of the representations, but not to the falsity thereof. On the contrary, he said that he assumed the representations to be true. No

witness was called to testify to the alleged falsity of said representations. Instead of calling any witnesses, Tway's counsel, over the objection of petitioner, was permitted to introduce in evidence and read to the jury a large number of excerpts from certain unsworn and unverified papers, to-wit:

1. Counsel read to the jury reports of National Bank Examiners to the Comptroller of the Currency, copies of which were sent to the Bank. These reports contained a vast quantity of hearsay information for the truth of which the Examiner expressly disclaimed any responsibility in the following language:

> "Much of the information in regard to the assets of the Bank is of such a character as to make it necessary for the Examiner to rely upon the good faith and assurances of his informants, and while the Examiner regards the statements so accepted by him as correct, he is, necessarily, not in a position to guarantee the accuracy of such part of the information as may not have been obtained at firsthand."

2. Counsel also read to the jury the voluminous Bill in Equity, filed by counsel for Receiver's predecessor against Bank Directors to recover damages for alleged negligence and statutory violations. This unverified Bill, after extensive hearings, was judicially held not proved in certain material particulars, which were, nevertheless, read to the jury and the Receiver was not permitted to show by the final judgment and

opinions of the Court that the facts alleged in the Bill and read to the jury had been disproved.

3. A tabulation of earnings, prepared by an accountant employed by Receiver for use in another case.

Conceding that the papers read to the jury were authentic copies of the originals, the Receiver objected to this extraordinary and unusual method of proof, for the obvious reason that the Bank Examiners, who prepared the reports to the Comptroller of the Currency, were not called as witnesses and placed under oath and thus made available for cross-examination, and because said reports were replete with hearsay, speculation, and secondhand information, to which the Examiner could not have testified had he been on the witness stand. Cross-examination is a fundamental right, even where it would be merely exploratory. In the present case, it was of paramount importance, in order to enable the jury to separate the parts of the reports based on the Examiner's personal examination of the books of the Bank from pure hearsay, for the source and accuracy of which the Examiner disclaimed responsibility. On the vital issue of whether the true purpose of Banco was to remove bad assets from the Bank or to engage in group or investment banking, as set forth in the Prospectus, the only evidence was the following hearsay statement contained in the Bank Examiner's report:

> "Your Examiner was advised that a plan is in contemplation, whereby a sort of finance and holding company will be organized with a large capital

> stock, say $20,000,000.00. The holding Company will hold, among other things, the stock of the National Bank of Kentucky and its affiliated bank through a surrender and exchange of the stock of the Bank for stock of the Company on some satisfactory basis. *It is also contemplated that the holding company will acquire, and through a term of years work out certain assets of the Bank, among others, probably Kentucky Wagon Manufacturing Company.*"

No other evidence was introduced to support the claim that the true purpose of Banco was to take over bad assets, such as the Kentucky Wagon Manufacturing Company.* The Court charged the jury:

> "Now the *only* evidence—at least of witnesses —tending to establish that is perhaps an *observation* in the Bank Examiners' reports, which is before you for consideration, that one of the officers, *presumably* Brown, had on *one occasion* stated that a corporation would be organized for *that purpose.*" (R. 1216.)

The Court will note that the Examiner does not say who advised him, and the Court's statement to the jury that it was an officer "presumably Brown" is a purely speculative assumption, emphasizing the danger of admitting hearsay evidence, not under oath and not subject to cross-examination.

Under the Federal Rules, the Receiver could not have called the Examiners for *cross*-examination. Thus

*This was one of the most severely criticized assets of the Bank, in which the ultimate loss exceeded $2,000,000.00. Atherton v. Anderson, 86 Fed. 2d 518; 99 Fed. 2d 883.

the right of cross-examination inherent in due process of law was effectually denied the Receiver. When the Receiver objected, the Court, although expressing "serious doubt" (R. 550) admitted the Examiners' reports *"in toto,"* including *all of the hearsay, speculative* and *second-hand statements contained therein.* In so doing, he stated:

> "The Court: Over my own opinion and idea and controlled by what appears to be the modern trend, I shall permit the jury to consider the Examiners' reports *in toto,* but shall advise the jury that *there was no opportunity for cross-examination of the Examiners."* (R. 1202.)

Counsel for petitioner made timely objection and moved to withdraw a juror and continue the case because of the prejudice resulting from this ruling (R. 238), and further stated (R. 1203):

> "This being our first opportunity to raise the question because it is the first time the matter has been finally ruled upon, we wish not only to object and except to that ruling[1] * * * but to raise the question that the ruling denies the plaintiff in this case its constitutional right under the Federal Constitution, viz.: the right to be confronted with the witness and cross-examine him, and the right to have the oath administered to the witness, and the right to have the testimony given in open court, and this ruling permits documents that contain conclusions, all kinds of hearsay by witnesses not shown to be qualified."

[1]Admitting the Examiner's reports *"in toto."*

The Court stated that he was "disposed to agree with counsel, not necessarily on his question as to the substantive rights, but *on the danger of the relaxation of the hearsay rules of evidence,*" but, nevertheless, adhered to his ruling (R. 1203).

The Court permitted the jury to find a verdict based upon these reports although the jury was cautioned:

> "That in some instances obviously the opinion expressed by the Examiner was based on matters *outside* the records of the Bank and were *opinions* formed upon facts not disclosed because the Examiners were not present and were *not available for cross-examination* by counsel representing the Receiver" (R. 1218).

The jury was also told that they were the exclusive judges of the facts and were at liberty to disregard the comments of the Court thereon (R. 1211).

The Receiver further objected to the defendant reading to the jury excerpts from the long Equity Bill filed by counsel for Receiver's predecessor, seeking to recover damages from the Bank Directors for alleged negligence and statutory violations, because it was an unverified pleading between different parties on different issues and in addition because the material allegations relied on in the present case as proof of the facts alleged had been judicially found to be incorrect upon the trial of the issues raised in the case against the directors (Atherton v. Anderson, 86 Fed. 2d 518, 99 Fed. 2d 883).

The trial Court overruled these objections and also excluded from evidence the proffer made by the Re-

ceiver of the opinions, and final judgment of the Court holding that these allegations of the Equity Bill had been disproved. The effect of this ruling was to make the statements contained in these unverified documents unimpeachable evidence and conclusive of the facts stated therein. The following is an excerpt from the record. Counsel for petitioner said (R. 1095):

> "We would like to offer the opinion of Judge Tuttle on illegal dividends; Judge Simons' opinion on losses on Banco stock, and Judge Hicks' opinion on losses on Banco stock *and the final entry.**
>
> "By the Court: I have concluded that they are inadmissible and we will not receive them in evidence. They may be proffered and made a part of the record" (R. 1172).

Counsel for petitioner then stated:

> "If the Court please, I have *the final decree in the Directors' case* and that is in a different category than the opinions in the other cases. It merely shows what the final decree held in that case."

Counsel for defendant objected, and the Court *refused* to submit the same to the jury (R. 1172, 1173).

We also objected to reading in the evidence excerpts from a report made by an accountant (White) employed by the Receiver in another case, because he was not called as a witness and not made available for cross-examination. Further, the correctness of the schedule of this accountant had been challenged by cross-exami-

*Opinions are part of record in Cause No. 7298, U. S. C. C. A. 6th and were ordered considered a part of this record on appeal.

nation in the case where it was offered in evidence and had been contradicted by a schedule prepared by other accountants (Vol. 2, R. 676, 677, 678, 684). The Court overruled the objection and counsel for defendant objected "on the ground that the witness who made the report is not here and we have no opportunity for cross-examination" (R. 677, 678).

The above papers which were read to the jury *constituted the only evidence of the alleged fraud.* Thus the Bank was convicted of fraud (1) without any witness being called to the stand, (2) without any sworn testimony and (3) without having the right to either cross-examine or (4) to contradict or impeach the unverified allegations of the Bill in Equity. Further, the finding of fraud necessarily rests on hearsay statements, contained in the Examiner's Reports, which would not have been admissible from the lips of the Examiner had he been sworn and placed on the witness stand.

SUMMARY STATEMENT AS TO QUESTION 4.

In the course of the trial before the jury, Tway testified that he was the exclusive owner of the 2,000 shares of Banco stock from the time of his original purchase thereof to the date of trial (R. 306). After the conclusion of the trial, the petitioner discovered that two months after the purchase of the Banco stock by Tway, he had sold or transferred the same to the R. C. Tway Coal Sales Company, a corporation of which Tway was the principal, but not the sole stockholder (Ex. 3, following R. 1294). Thereafter the Coal Company and

not Tway was in fact the sole owner of the Banco stock. Liability for the purchase price of the stock became that of the corporation and Tway sustained no damages as a result of his purchase. Under these facts Tway, having sustained no damage, could claim no damages by way of defense.

Affidavits were filed on behalf of the petitioner, substantiated by records of the corporation, showing the sale of the Banco stock to the R. C. Tway Coal Sales Company (Ex. 3, following R. 1294). Tway made an affidavit, in which he admitted that the stock was owned exclusively by the corporation and not by him, as he had testified before the jury (R. 1283). In the affidavit he contended that he had acted as an undisclosed agent for the corporation in making the original purchase. The Receiver filed counter-affidavits tending to disprove the claim that Tway acted as an undisclosed agent and showing that he had purchased the stock and then sold it to the corporation (R. 1271, 1282). The Court of Appeals said that the newly discovered facts established that Tway made "concededly false representations to the Receiver" in the affidavit for offset and gave "concededly untrue evidence in the trial below."

The Court of Appeals points out that all of the material factors upon which Tway's defense rests were "supported only by the assertions of Tway himself and the jury's verdict may be explained only by its acceptance of Tway as a witness whose credibility and accuracy of memory could be relied upon." Judge Simons, in his opinion, then recites the judicial history of Tway's operations in stocks and concludes "in the

light of that history, which I am unable to ignore, and which the Court should not ignore, Tway's explanation of his concededly false representations to the Receiver and his concededly untrue evidence in the trial below is wholly incredible and might well be thought so by a *jury*. Since his claim of reliance upon fraudulent concealment in ignorance of the infirmities in the Bank's position, notwithstanding published criticisms of it which came to his notice prior to his renewals, payment of interest, and acceptance of dividends, rest entirely upon his own word a *jury* should be permitted to appraise the accuracy of his memory and the credibility of his evidence bearing upon the vital issues of the case in the light of the newly discovered facts. I think the Court should have granted the motion for a new trial."

Judges McAllister and Hicks were of the opinion that "newly discovered evidence which tends merely to affect the weight and credibility of evidence does not constitute a proper basis for a new trial. Under the circumstances of this case, it does not appear to me the denial of the motion for a new trial on the ground of newly discovered evidence that would *only affect the credibility of Tway,* was an abuse of discretion on the part of the district court." Thus the question arises: —Where the *sole* witness has given *false evidence* before a *jury* and the *verdict rests on such false evidence,* does the usual and accepted course of judicial procedure require a new trial, in order that the rightful triers of the fact, to-wit: the jury, may pass upon the credibility of the witness or may the Court take away the right to have a jury pass thereon?

SUMMARY STATEMENT AS TO QUESTION 5.

The National Bank of Kentucky promoted the organization of the BancoKentucky Company as fully set forth in the opinion of this Court in Anderson, Receiver, v. Abbott, 321 U. S. 349. Tway's case was based on the claim that the Bank was engaged in selling to him common stock of the BancoKentucky Company. In the opinion below, Judge Simons correctly said "It is agreed that the promotion of Banco was beyond the legitimate powers of the Bank and *ultra vires.*" Citing Dietrick v. Greaney, 309 U. S. 190; D'Oench, Duhme Co. v. F. D. I. C., 315 U. S. 447; F. D. I. C. v. Vest, 122 Fed. 2d 765 (C. C. A. 6).

In addition, this Court said in First National Bank of Ottawa v. Converse (1906), 200 U. S. 425, "A national bank has no power to engage in or promote a speculative business."

The loan of money by the Bank to Tway and the giving of his note to repay the loan were clearly proper banking functions. Tway asserts, however, that the purpose of the loan was to induce him to buy Banco stock. The promotion of Banco, the sale of its stock and any representations in connection therewith were all beyond the proper powers of a national bank. Tway's defense, based upon such *ultra vires* acts, was identical with the defense attempted in the D'Oench, and Dietrick cases, *supra.* In both cases, this Court held because of the "evil tendency of the acts to contravene the policy governing banking transactions" the

defendant was estopped to plead such acts to escape payment of his note.

The Court below said: "Here it is but claimed that Tway participated in a transaction which through experience he knew to be was beyond the authority of the Bank." In addition to knowing "through experience" he was specifically told by Thieman that the Bank was promoting Banco to "do and perform functions that a national bank could not do; that it could underwrite issues, invest—buy and sell stocks, underwrite mortgages, participate in management of industry and do a general business that could make a great deal of money" (R. 165). To the same effect, see R. 341, 345.

The Court below said that Tway "denied such knowledge and the question was one for the jury." It is apparent from the above record references that Tway did not deny knowledge that the enterprise was beyond the corporate powers of the Bank, but in any event the trial Court did not submit the question to the jury as Judge Simons indicated should have been done. On the contrary, the trial judge eliminated as a defense petitioner's claim that Tway participated and joined with the Bank in the promotion of BancoKentucky with full knowledge that he was participating in the *ultra vires* transaction. The trial Court instructed the jury that this was "immaterial" (R. 1216). This instruction, affirmed below, is contrary to the applicable decisions of this Court.

SUMMARY STATEMENT AS TO QUESTION 6.

At the time of the representations and the purchase of Banco stock (October 1, 1929) the issue price was $25.00 per share. The stock was listed on the Chicago Stock Exchange and regularly traded in at daily quoted market prices (R. 297). The market price appreciated so that on October 15, 1929, the market price of Banco was $34¼ per share, and Tway could have sold at a profit of approximately $18,000.00 (R. 294, 295). The disastrous stock market panic followed thereafter but notwithstanding the sensational collapse of all stock prices, the market price of Banco stock was such that Tway could have sold his stock for the cost price or at a slight profit (R. 301). Tway held for higher prices. The stock had a substantial market value until after the failure of the National Bank of Kentucky when it was quoted as low as $1.00 per share (R. 304).

Irrespective of market value, BancoKentucky stock had a substantial intrinsic value at the time of its purchase and for a long period thereafter. The only criticism of Banco assets made at the trial was with respect to the value of the stock of the Bank of Kentucky held by Banco. However, Banco also held the stock of The Louisville Trust Company and a number of other banks. The soundness of these institutions was admitted (R. 20, 379, 810). They constituted approximately half of the asset value of Banco stock.

The ultimate loss of all value of Banco stock was due to the independent acts of the directors of Banco. These independent acts consisted of a loan of $2,000,-

000.00 to James Brown made November 14, 1929 (R. 1038). The sale of the Brighton Bank in Cincinnati for a loss of $3,445,000.00 in the Fall of 1930, and a loss of $3,573,000.00 on the sale of the Pearl Market Bank at approximately the same time (R. 1060). Tway knew of these investments when they were made (R. 353-357). Further, the ultimate collapse was caused by the Caldwell deal made May, 1930, more than six months after Tway bought his stock (R. 777).

Tway was permitted, at the trial, to show these subsequent events as proof of damages and fraud. Judge Simons holds this was error since "neither Thieman nor the Bank was a guarantor of the financial success of the Banco venture and neither could be charged with knowledge of future events."

This Court said in Anderson v. Abbott "*The stockholders of Banco cannot escape responsibility for the inadequacy of Banco's resources merely because the choice of its investments was made by the officers and directors—acts in which the stockholders did not participate and of which perhaps they had no actual knowledge.*"

The defendant chose to retain the ownership of Banco stock. He received and kept the dividends thereon. It was not until suit on his note by the Receiver that he disclaimed liability. His defense is based solely on misrepresentations of the Bank, causing him damage *at the time of the purchase of his stock*. There is no reason why the universal rule that damages are the difference "between the price paid and the real intrinsic value of such shares at the time of their pur-

chase" should not have been applied. Hindman v. First National Bank, 112 Fed. 931 (1902). Opinion by Judge Lurton, subsequently a Justice of this Court.

In Smith v. Bolles, 132 U. S. 125, this Court said, "If the stock had a value in fact, that would necessarily be applied in reduction of the damages."

Instead of applying the settled law to the present case and instructing the jury to ascertain the damages sustained by Tway as the result of the alleged misrepresentations and to deduct the same from the amount due on his note, the trial judge instructed the jury that if there were any false representations, they should completely exonerate Tway from any liability on his note.

The net effect of the affirmance of these instructions has been to charge the Receiver with the losses in value which occurred long after the misrepresentations complained of and which were due entirely to the independent acts of the Corporation long after Tway became a stockholder thereof. Such rule is contrary to the opinion of this Court that "the stockholders of Banco cannot escape responsibility for the inadequacy of Banco's resources merely because the choice of its investments was made by the officers and directors." Tway's remedy with respect to improper investments was by action against the officers and directors of Banco for mismanagement.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

(Relating to Questions 1, 2 and 3.)

The Court of Appeals sanctioned such a departure, by the lower court, from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision. The departure, complained of, is that the lower court disregarded the requirements of the Federal Constitution with respect to due process of law and found the Bank guilty of a charge of fraud without any sworn evidence of the fraud and without the Bank having the right to cross-examine witnesses against it.

The Court further departed from the accepted and usual course of judicial proceedings by admitting as evidence of fraud hearsay statements contained in unverified documents and sustaining a finding of fraud based thereon.

The questions involved in the Tway Case herein presented will also arise in numerous cases now pending on notes given to the Bank by debtors who assert similar defenses. Twenty other cases have been continued awaiting the outcome of the present case. The amount involved ($640,000.00) is sufficient to be of importance to the large number of depositors of the Bank (30,906). However, the questions herein involved transcend in importance the immediate controversy between the Bank and its debtors. These questions involve the extent to which official documents and reports may be used in the trial of actions in the Federal courts to accomplish the introduction into evidence of hearsay

statements, opinions, speculation and assumptions of Federal officials and examiners, based upon second-hand information without the necessity of placing the author of such documents and reports under oath, and subjecting the person responsible therefor to cross-examination.

This is an important question of Federal law which has not been, but should be, settled by this court. The rule sanctioned below has far-reaching consequences—not confined to the parties to this case. It extends far beyond the supervision of national banks.

The trial court admitted the Examiner's reports "*in toto,*" including all of the hearsay statements, opinions and conclusions based upon second-hand information derived from undisclosed sources, *on the theory that said reports were official documents and were admissible under an exception to the hearsay rule.* This exception applies only to official reports and books recording primary facts, 20, Am. Jur. 866, Par. 1027. "Expressions of opinion and the making of conclusions, are not admissible in evidence as public records." The trial Judge recognized that the extension of the exception to the rule, which he permitted in the present case, was not only contrary to his personal opinion, but constituted a *dangerous* relaxation of the hearsay rules of evidence (R. 1203).

In the opinion of the Court of Appeals, Judge Simons said:

> "So with hearsay statements in the examiners' reports. While as official records they may be admissible to show such facts as are within the per-

sonal knowledge of the examiner, I doubt their admissibility in respect to statements clearly indicated as those of informants, whose accuracy is not guaranteed. Nagle v. United States, 145 Fed. 302, C. C. A-2.

"If such statements are admissible, then the faintest breath of rumor or scandal may be legitimatized as evidence merely by including it in an official report. This cannot be the law."

The separate opinion of Judge McAllister, in which Judge Hicks concurred, is silent on this subject.

Although Judge Simons says "This cannot be the law," it will not only become the law in the present case, but constitute a precedent for all pending and future cases, unless this court exercises its supervisory jurisdiction with respect thereto. Thus, the problem presented becomes one of vast importance because of the centralization of Governmental functions and the tremendous growth of official records and reports of various Governmental agencies and the numerous examiners employed by them, of which the court may take judicial knowledge.

If the inclusion of hearsay, the expression of opinions and conclusions based on unknown sources, and second-hand information may be introduced in evidence in support of charges of fraud, or as affirmative proof in any of the numerous issues which arise between citizens, or between citizens and their government, without the necessity of an oath or cross-examination merely because included in an official report, then our traditional conception of due process of law must be materially altered.

This Court has held that:

> "Cross-examination is a matter of right * * * It is the essence of a fair trial that reasonable latitude be given the cross-examiner even though he is unable to state to the Court what facts a reasonable cross-examination might develop. Prejudice ensues from a denial of the opportunity to place the witness in his proper setting and put the weight of his testimony and his credibility to a test, without which the jury cannot fairly appraise them. * * * In this respect a summary denial of the right of cross-examination is distinguishable from the erroneous admission of harmless testimony." Alford v. United States, 282 U. S. 687 (1931), at page 691.

See also the Ottawa case, 70 U. S. 268 (1865), at page 271.

Nor could the Bank call the Examiners as witnesses on its own behalf and at the same time cross-examine and contradict them. The Phil & Trenton v. Stimpson, 39 U. S. (14 Pet.) 448 (1840).

The action of the trial Court in permitting these unverified documents to go into evidence "*in toto*" was contrary to the applicable decisions of this Court safeguarding the right of cross-examination.

The decision of the trial Court permitting defendant to put in evidence the unverified equity bill of the Receiver, claiming damages against the directors, was contrary to the decision of this Court in Delaware County Commissioner v. Diebold Safe and Lock Co., 133 U. S. 473 (1890). The Court of Appeals recognized

that this was so and also that it was contrary to the accepted practice in Kentucky (Rankin v. Maxwell, 9 Ky. 828). However, the Court of Appeals disregarded the opinion in this Court in favor of the so-called "modern view," citing The Rockland v. Farnsworth, 89 Me. 481 (1897). But the trial Court went beyond the mere admission of this unverified pleading as affirmative proof of fraud. The trial Court held that the allegations of the Bill could not be impeached or contradicted by showing that upon the trial and decision of the Directors' case many of the material allegations relied on by the defendant had not been sustained. The Receiver offered in evidence the opinions and the final decree of the Court holding that certain of these material allegations read to the jury were not proved. The jury was charged that they could consider the allegations of the Bill in Equity as proof, but were prevented from knowing that such allegations had been judicially disproved. Although the Receiver recovered damages against the directors on certain items of his claim, he was denied recovery on the particular allegations relied on by defendant in the present case. For example: The Receiver contended in the Equity Bill that the directors were liable for loans made on Banco stock on the theory that the Bank and Banco were in effect a single entity. The Court held against this claim. Atherton v. Anderson, 86 Fed. 2d 518, at page 536 (C. C. A. 6, 1936).

Although Judge Simons said in the opinion in the present case that the Equity Bill was properly admitted, he also said that:

> "The party who made the pleadings is, however, permitted to show that his allegations were erroneous. (Citing cases.) Since the opinion in Atherton v. Anderson, *supra,* was an adjudication that there was no fraudulent intent in the organization of Banco, the Receiver should have been permitted, by means of it, to demonstrate the error in the allegations of his pleading."

The majority Judges said nothing with respect to this fundamental error.

Although counsel for Tway, in the Court of Appeals, said he did not now rely on his allegation that Banco was organized for the purpose of removing bad assets from the Bank, Judge Simons correctly said:

> "That issue was, however, submitted to the jury and there can be no doubt that the evidence bearing thereon was prejudicial."

Again the majority Judges are silent. We submit that the action of the trial Court in receiving in evidence an unverified Bill in Equity, which Professor Wigmore characterizes as "conventional rigamarole" and for this reason not receivable in another suit as an admission* was directly contrary to the applicable decision of this Court. However, the action of the trial Court in refusing to permit the pleader to show that the allegations of his Bill had been judicially disproved and held contrary to fact, had the effect of making the same unimpeachable and constituted a denial of due process. Tot v. United States, 319 U. S. 463 (1943); Western

*Wigmore on Evidence (1904 Edition), Volume 2, Section 1065, P. 1243.

Atlantic R. Co. v. Henderson, 279 U. S. 639 (1929). In Saunders v. Shaw, 244 U. S. 317 (1917), Justice Holmes said, in reversing the State Court for refusal to permit cross-examination:

> "We cannot be sure the defendant's rights are protected without giving him a chance to put his evidence in."

When the trial Judge denied the Receiver the right to cross-examine and to put the evidence in the ruling constituted a departure from the accepted course of judicial procedure and also violated the constitutional requirement of due process.

Reasons Relating to Question 4.

Judge Simons points out that defendant gave "concededly false representations" to the Receiver and "concededly untrue evidence" in the trial below (R. 1371). This fact was discovered after the conclusion of the trial. Under these circumstances, it would seem clear that where the sole witness has given false testimony on material facts and the case is one in which the plaintiff is entitled to a jury, the case should have been remanded for re-examination of the issues at common law before the jury, and the Court did not have the right to take this fact issue from the jury. As the Opinion of Judge Simons states:

> "A jury should be permitted to appraise the accuracy of his memory and the credibility of his evidence, bearing upon the vital issues of the case in the light of the newly discovered facts."

We submit that this Court should exercise its supervisory powers to insure to plaintiff the verdict of a *jury* based on the truth and not on false evidence.

Reasons Relating to Question 5.

The assertion of a defense based on knowing participation with the Bank in concededly *ultra vires* acts "contravenes a general policy to protect the institution of banking" therefrom. D'Oench, Duhme & Co., Inc., v. F. D. I. C., 315 U. S. 447 (1942), at p. 458. In Dietrick v. Greaney, 309 U. S. 190 (1940), Mr. Justice Stone, in holding that the Bank Receiver could recover on a note given in substitution for shares of stock as a means of avoiding the consequences of violation of a statute, said (p. 196):

> "It is the evil tendency of the prohibited acts at which the statute is aimed, and its aid, in condemnation of them and in preventing the consequences which the act was designed to prevent, may be invoked by the Receiver representing the creditors for whose benefit the statute was enacted."

The Court of Appeals apparently recognized that if Tway had knowledge of the *ultra vires* character of the act and participated with the Bank, he ought not be permitted to recover, but said that the question of knowledge was a jury issue (R. 1367-8). However, the Court was mistaken in its apparent belief that the trial Court had submitted this issue to the jury. The trial

judge instructed the jury that the issue was "immaterial" (R. 1216).

The issue is material and involves an important question of Federal law pertaining to the protection of depositors and creditors of national banks and that this Court should review the decision, in order to correct the error below, in accordance with the applicable decisions of this Court.

Reasons Relating to Question 6.

We have previously pointed out that the ultimate loss of value of Banco stock was due to the independent acts of the corporation after defendant became a stockholder thereof. This loss was not due to any misrepresentations of the Bank. It was a loss for which this Court said, in Anderson v. Abbott, *supra, "The stockholders of Banco cannot escape responsibility."* However, the decision below permits Tway to avoid all responsibility for the acts of the corporation of which he was a stockholder which occurred long after the alleged misrepresentations. Assuming that misrepresentations were made concerning the value of the National Bank of Kentucky, the damages due to such misrepresentations should have been determined by way of counterclaim and applied in reduction of the liability of Tway on his note.

Tway borrowed $50,000.00 from the Bank. That money was credited to his account and was withdrawn from the Bank's assets by Tway's check and paid over to BancoKentucky Company. The Bank's assets were

thereby depleted. The Receiver should recover this money less any damage due to the Bank's misrepresentations. The gist of the so-called defense is that Tway was misled with respect to the purchase of the stock. Although designated a defense, it was in fact a counterclaim. The rules of civil procedure cover the situation. Rule 8(c) provides:

> "When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the Court on terms, if justice so requires, shall treat the pleading as if there had been a proper designation."

An important question of Federal procedure is thus presented. Should the Court have carried out the mandatory provisions of the Rule? It was conceded that if Tway had made an affirmative claim, he could not recover the full value of the stock, but his recovery would be limited to the damages by reason of the vice which he claims existed at the time of its purchase. The lower Court, by failing to apply the rule permitted Tway to shift to the depositors of the National Bank of Kentucky the loss which resulted from the acts of the officers of Banco—acts which occurred long after his purchase. It is submitted that this calls for the exercise of this Court's supervisory jurisdiction.

CONCLUSION.

Petitioner has been denied the very essence of a fair trial. The opinion written by Judge Simons clearly elucidates a number of prejudicial errors which occurred in the trial. The opinion of Judge McAllister is limited to the sole question of the newly discovered evidence. No answer or comment is made with respect to any of the other vital and serious errors of the trial Court set forth by Judge Simons and elaborated herein. We respectfully submit that the petition for writ of certiorari should be granted.

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Attorneys for Petitioner.

January , 1945.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinions below are referred to in the petition for writ of certiorari under this same caption.

JURISDICTION.

The statement as to jurisdiction is set forth in the petition for writ of certiorari.

STATEMENT OF THE CASE.

The facts upon which the questions presented arise have been stated in the "Summary Statement" thereon in the petition for writ of certiorari.

SPECIFICATIONS OF ERROR.

1. The Circuit Court of Appeals erred in affirming the judgment of the District Court, which found in favor of the defendant and denied the motion of petitioner for a verdict and judgment in his favor on his petition.

2. The Circuit Court of Appeals erred in not ordering judgment in favor of the plaintiff on his petition.

3. The Circuit Court of Appeals erred in affirming the Order of the District Court, which denied the mo-

tion of petitioner for a new trial for errors occurring at the trial and in not granting a new trial to the petitioner.

4. The Circuit Court of Appeals erred in affirming the Order of the District Court which denied the petitioner a new trial on account of newly discovered evidence and in not ordering a new trial on account thereof.

5. The Circuit Court of Appeals erred in not holding that the defense should be treated as a counterclaim in accordance with Rule 8(c) of Rules of Civil Procedure.

6. The Court of Appeals erred in permitting the defendant to introduce into evidence unverified documents and in denying to the petitioner his constitutional right to cross-examine with respect thereto and to offer affirmative evidence to disprove and impeach the allegations thereof.

ARGUMENT.

We have shown in the summary statement the most unusual situation in which a bank has been found guilty of an alleged fraud without the testimony of a single witness thereto and without the presentation of any sworn evidence, merely upon allegations contained in unverified documents. Further, many of the allegations upon which the finding of fraud necessarily rests were mere hearsay, opinions and conclusions contained in reports of Examiners made to the Comptroller, which the Examiner himself warned were nec-

essarily obtained from "informants" and that he was "not in a position to guarantee the accuracy of such part of the information as may not have been obtained at first-hand."

It is obvious that no Federal Judge would so far violate the fundamental requirements of the Fifth Amendment to the Constitution, without some alleged basis for permitting unsworn evidence, hearsay, conclusions and opinions to go before the jury. It is, therefore, important to consider the grounds upon which the District Court justified his admission of this evidence without according to the petitioner any right of cross-examination. The basis of the action of the trial Court was Section 661, Title 28, U. S. C. A., which provides:

> "Copies of any books, records, papers or documents in any of the executive departments authenticated under the seals of such departments shall be admitted in evidence equally with the originals thereof."

Further, Section 663, Title 12 U. S .C. A. reads:

> "Every certificate, assignment and conveyance executed by the Comptroller of the Currency in pursuance of law and sealed with his seal of office, shall be received in evidence in all places and courts. * * *"

These statutes do not define the probative effect of such documents. It was further claimed that under Rule 43 of the Federal Rules of Civil Procedure:

> "All evidence shall be admitted which is admissible under the Statutes of the United States,

> or under the rules of evidence heretofore applied in courts of the United States on the hearing of suits in equity, or under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States Court is held."

Further, Section 1636 and 1637 of the Kentucky Statutes in force at the time of the trial of this case provide as follows:

> "Section 1636: All records and exemplifications of office books, kept in any public office of the United States * * * shall be evidence in this State if attested by the keeper of such records or books and the seal of his office, if there be a seal."

Section 1637:

> "Exemplifications from the books of the executive department of the United States or any papers filed therein shall be evidence when attested by the President or the chief of either of the departments; * * *"

These statutes were intended as a matter of convenience to authorize the production of authenticated copies instead of requiring the keeper or the maker of the originals to produce them in Court. Authentication was not and is not insisted upon in this case by the Receiver. He concedes that the papers produced were authentic copies of the originals, but he contends that the originals would not be competent proof in the present case of the hearsay conclusions and opinions contained therein.

The exception to the hearsay rule, which permits the introduction of official records, without calling the author thereof as a witness, is limited to official records and reports of primary facts and transactions in which the Government is directly concerned. (Moses v. United States (1897), 166 U. S. 571; Chesapeake & Delaware Canal Co. v. U. S. (1919), 250 U. S. 123; see also U. S. v. Bell (1884), 111 U. S. 477.

Defendant contended in the Court below that the Bank Examiners' reports were public records, because the same were made pursuant to law which requires examination of national banks twice each year by national bank examiners appointed by the Comptroller of the Currency. Section 481, Title 12, U. S. C., provides that:

> "The examiner making the examination of any national bank or of any other member bank shall have power to make a thorough examination of all of the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath, and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency."

In the present case, the Examiner did not administer the oaths referred to and in any event the portions of the Examiners' reports objected to do not relate to primary records of any facts. The primary facts would be contained in the books and records of the bank. The character of reports introduced in evidence in the present case are of an investigatory nature.

Reports of an investigation based on secondary evidence is never admissible under the alleged exception to the hearsay rule. Our position on this point is stated in 20 Amer. Jurisprudence, p. 866, Par. 1027, as follows:

> "According to the theory advanced by some courts, a record of a primary fact made by a public official in performance of official duty is, or may be made by legislation, competent *prima facie* evidence as to the existence of that fact, *but records of investigations and inquiries* conducted either voluntarily or pursuant to requirement of law by public officers concerning causes and effects and involving the exercise of judgment and discretion, expressions of opinion, and the making of conclusions, *are not admissible in evidence as public records.*"

Incompetent evidence does not become competent because it is included in an official report. In United States v. Corwin, 129 U. S. 381 (1889), the Court, in discussing the introduction of official reports, said:

> "Manifestly the design and meaning of this rule is not to convert incompetent and irrelevant evidence into competent and relevant evidence simply because it is contained in an official communication. Had the officer been testifying under oath, such an assertion would have been excluded as inadmissible upon the ground that the statement itself implied the existence of primary and more original and explicit sources of information. * * * The Courts held this rule, which has been invoked, to be limited to only such statements in official documents as the officers are bound to make

> in the regular course of official duty. The statement of the extraneous or independent circumstances, however naturally they may be deemed to have a place in the narrative, is no proof of such circumstances, and is, therefore, rejected" (p. 386).

In accord, see Nagel v. U. S., 145 Fed. 302, C. C. A. 2 (1906); U. S. v. Case, 49 Fed. 270 (1892).

We do not contend that a national bank examiner's report is not admissible in so far as the same is competent and relevant when the examiner is called to the witness stand and qualified in the usual and customary way. The summary of the books contained in a national bank examiner's report is just as competent as the summary prepared by any expert accountant but the accountant, the books and papers must be available for cross-examination. This was specifically held in Jeffreys v. O'Neal, C. C. A. 4 (1933), 64 Fed. 2d 284, where the Court held

> "Report of experienced national bank examiners as to bank's condition, supported by testimony of examiner and by books and papers on which report was based is competent evidence."

The trial Judge in the instant case in admitting the Examiner's reports said:

> "Over my own opinion and idea, and controlled by what appears to be the *modern trend,* I shall permit the jury to consider the examiner's reports *in toto,* but shall advise the jury that there was no opportunity for cross-examination of the examiners. * * *" (R. 1202.)

We know of no such "modern trend." Professor Wigmore, on evidence, states:

> "It may be said that the tendency of the courts is to disprove, rather than to favor, the admission of such reports or inquisitions * * *." 1904 Edition, Vol. 3, Par. 1672, p. 2080.

However, no such alleged exception to the hearsay rule justifies the admission of excerpts from the report of an accountant (White) as to the Bank's earnings, and charged off loans and net addition to reserves from April 1, 1927, to December 31, 1929. The accountant who prepared this report was not a public officer. His tabulation was not an official report or record. He was employed by the Receiver in another case long after the Bank closed. Summaries of accountants are only admissible when the accountant is placed on the witness stand under oath and the books are available and he is subject to cross-examination. Morton, Butler Timber Co. v. U. S., 91 Fed. 2d 884 (1937). The defendant contended this evidence was admissible because it had been introduced in evidence by the Receiver in another case. But in that case White was called as a witness and was severely cross-examined to show that the exhibit was incorrect. (See Record No. 8852, Anderson v. Abbott, pp. 135, 136.)

The excuse for permitting the defendant to read into evidence numerous paragraphs from the Bill in Equity against the bank directors in Keyes, Receiver, v. Akers, was that the Receiver had relied upon the allegations of the Bill in his suit against the directors.

The Equity Bill was not verified and was signed by Receiver's counsel, not by the Receiver. Tway was not a party to the Directors' Suit. Under these circumstances, the unverified Bill of Complaint was incompetent to prove an admission or to constitute affirmative evidence of fraud. This is directly held in Delaware County Commissioners v. Diebold Safe & Lock Co. (1890), 133 U. S. 473, at 487:

> "The former complaint not under oath nor signed by plaintiff, but only by its attorneys, was clearly incompetent to prove an admission by the plaintiff that upon those facts it had not a cause of action against this defendant."

In accord are:

Combs v. Hodge (1858), 21 How. (62 U. S.) 397, at p. 404;
Fidelity & Casualty Company of New York v. The Brightman, 53 F. 2d 161 (C. C. A. 8, 1931);
Fidelity & Deposit Company of Maryland v. Redfield, 7 F. 2d 800 (C. C. A. 9, 1925).

Kentucky rulings also accord:

Rankin v. Maxwell, 2 A. K. Marshall, 9 Ky. 828;
Lane v. Bryant, 100 Ky. 138 (1896).

Professor Wigmore on evidence states that there grew up with the development of chancery pleading a marked distrust of a bill because the practice in drafting was such that the allegations were understood to be in large part mere "conventional rigamarole." He concludes "For these reasons the doctrine came to be settled that a bill in chancery was not receivable in

another suit as an admission." 1904 Edition, Vol. 2, 1065, p. 1243.

Assuming *arguendo* that the bill was admissible, it certainly was not irrefutable. The jury was entitled to know that many of the allegations made therein had not been sustained upon the final determination of the case by the Court. Therefore, we offered in evidence, as appears in the summary statement, the final opinions and decree of the Court in the Directors' Liability case. The trial Judge excluded the opinions and the final decree from the consideration of the jury and thereby made the Bill in Equity conclusive proof of the facts alleged therein. The Court assigned no reason for this ruling and we know of none that can justify it. Even statutes which create "conclusive" presumptions are held invalid. Western Atlantic R. Co. v. Henderson, 279 U. S. 639 (1929); Tot v. United States, 319 U. S. 463 (1943); *In re:* Allen, 82 Vermont, 365; Johnson v. State, 55 Md. 350; Gibson v. Pekanek, 25 So. Dak. 281; Larson v. Dickey, 39 Nebr. 386; Cairo & Fulton R. R. Co. v. Parks, 32 Ark. 131; McCready v. Sexton & Son, 29 Iowa, 356; South Cotton Oil Co. v. Raines, 121 Ga. 154; Missouri K. & T. Ry. Co. v. Simonson, 64 Kansas, 802.

We respectfully submit that where there is no sworn testimony, where no witness appears, where there is no opportunity for cross-examination, and to cap the climax where documents prepared by persons having no connection with the Bank, are held uncontradictable proof of their contents and constitute the only evidence of the fraud complained of against the Bank,

every safeguard inherent in due process is thrown to the winds. The denial of cross-examination, the elevation of hearsay evidence to legitimacy and the denial of the right to contradict the Bill versus the Directors was a denial of the "opportunity to be heard." Powell v. Alabama, 287 U. S. 45 (1932), at p. 68; Holden v. Hardy, 169 U. S. 366 (1898), at p. 389.

TWAY CANNOT DEFEAT THE NOTE ON THE BASIS OF ALLEGED ULTRA VIRES ACTION OF THE BANK IN WHICH HE KNOWINGLY PARTICIPATED.

Tway contends that the Bank should suffer the loss resulting from the impairment of value of the Banco stock, because it induced him to buy the stock and misrepresented the facts in doing so. He contends that the making of the loan was only one of the steps in a scheme to organize and finance Banco. He is relying on *ultra vires* acts of the Bank to sustain his defense. In the trial Court, Tway contended that *ultra vires* was no defense. This is true where the corporation raising the defense of *ultra vires* has gained a benefit. In such case, it is estopped without returning the benefit received, to set up the defense of *ultra vires*. Here, however, the National Bank of Kentucky did not benefit from making the loan to Tway. Its assets were not augmented. They were depleted when the $50,000.00 was withdrawn from its assets and paid over into BancoKentucky. The trial Court ruled that the defense of *ultra vires* was unavailable without regard to the question of whether a benefit was received or not

because Tway was asserting the defense of fraud. The Court charged the jury:

> "Something has been said * * * that since the Bank under its charter was not authorized to engage in the business of selling stocks of other corporations, that any transaction with respect to this Banco stock by the Bank would be *ultra vires* —that is, beyond its corporate powers—and that no officer of the Bank would be able to enter into any binding contract with respect to it and that, therefore, the representations with respect to the value of the stock, or the supporting stock, would be wholly immaterial. That is not the situation where deceit, fraud—either in affirmative misrepresentation or concealment—is relied upon. And whether the transaction was within its corporate powers or not within its corporate powers is immaterial if you find from the evidence that there were fraudulent misrepresentations or concealments relied upon by the defendant as inducing him to make the note and relied on in the contract" (R. 1216).

In the Appellate Court, Judge Simons recognized the error in this instruction. He considered this Court's rulings in Dietrick v. Greaney, 309 U. S. 190 and D'Oench, Duhme & Co., Inc. v. F. D. I. C., 315 U. S. 447, applicable if "Tway participated in a transaction which * * * he knew to be beyond the authority of the bank" (R. 1368). He interpreted the record as containing a denial on the part of Tway of such knowledge. This is disputed by the Receiver. Instead, the Receiver contends that Tway admitted such

knowledge. Tway copied in his answer the Prospectus on which he said he relied and which reveals that the Bank was going to engage in *ultra vires* action in organizing Banco. He related to the jury the statements Thieman made to him, to the effect that Banco, when organized by the Bank, would "do and perform functions that a national bank could not do" (R. 165) (See 1395-1397). However, conceding that there was a denial in the record, we are left with a difference of fact between the plaintiff and the defendant as to whether Tway "knew" or not. This, Judge Simons states, was a "question * * * for the jury" (R. 1368). However, the jury was foreclosed from considering this question when the Court instructed the jury that "whether the transaction was within its corporate powers or not within its corporate powers is immaterial if you find from the evidence that there were fraudulent representations or concealments" (R. 1216).

Judge Simons states that the majority of the Court "agree with all of the views herein expressed, except in respect to the admission of certain evidence (and) * * * they disagree also with the view that the newly discovered evidence" requires a new trial (R. 1359). Judge McAllister stated that he concurred with Judge Simons "except as therein noted" (R. 1371).

We must take it, therefore, that all three members of the Court were in agreement that this was a question that should have been submitted to the jury. Nevertheless, it was not so submitted.

TWAY CANNOT SHIFT THE LOSS, RESULTING FROM ACTS INDEPENDENT OF AND SUBSEQUENT TO THE ALLEGED MISREPRESENTATIONS, TO THE DEPOSITORS.

The assets of the National Bank of Kentucky were depleted when Tway, by his check, withdrew that much money and paid it into Banco for the stock which he bought. Conceding, for the sake of argument, that Tway has a claim against the Bank for inducing him to buy that stock, he cannot shift the loss to depositors in so far as the loss results from matters arising after he acquired the stock. Tway admits, in his petition, that one of the assets of Banco from the very start was the stock of the Louisville Trust Company and that this Bank had a valuation of $8,000,000.00 (R. 20). This, he testified, was one of the "cornerstones" of Banco (R. 338, 340, 347). The Louisville Trust Company was in sound financial condition (R. 810). Tway "had no complaint on account of the Louisville Trust Company" (R. 379). Banco concededly had other assets consisting of cash and its ownership in the Cincinnati Banks. After Tway bought his stock, Brown was elected President of Banco (R. 336). This was with the full approval of Mr. Tway. Brown borrowed $2,000,000.00 of Banco's money without knowledge of the directors of Banco. He used the money for his own purposes (R. 1038). $1,500,000.00 was lost by Banco on this transaction. The depositors of the National Bank of Kentucky should not be required to bear the burden of this loss resulting from Tway's mis-

placed confidence in selecting Brown as an officer of Banco. Banco lost almost $7,000,000.00 when it sold the Cincinnati Banks one year after Tway bought his stock. It lost millions as a result of the Caldwell deal, which was not initiated until six months after Tway bought his stock (R. 777).

Tway sought to shift the entire loss to the depositors, by setting up the claim of fraud as a defense. It is submitted that the case called for the application of Rule 8(c) of the Rules of Civil Procedure. Justice required that the pleading should have been treated as a counterclaim.

The Court of Appeals of Kentucky Has Held, in a Similar Situation, That There Was No Defense to the Note.

This Court was advised in the assessment suit that "some $9,900,000.00 in cash was realized by Banco from the sale of its shares—about $6,000,000.00 of which was financed on loans from the Bank and from the Trust Company" Anderson v. Abbott, *supra*.

Reference has already been made to the suits against other borrowers of money from the Bank and the fact that those cases have been held in abeyance pending final decision in the present suit. In one case, however, brought in the State Courts of Kentucky, there has been a final decision. Beck v. First National Bank of Charlestown, Indiana (1933), 250 Ky. 764, 63 S. W. 2d 937. The plaintiff Bank in that case recovered on two grounds. One of them was that there was no actionable fraud. The Court of Appeals of Ken-

tucky, after setting out the elements necessary to constitute actionable fraud stated:

> "The evidence leaves it exceedingly doubtful if the necessary elements 2 (that it was false) and 3 therein (that it was known to be false or made recklessly without any knowledge of its truth and as a positive assertion) or either of them, were proven. On the contrary, defendant's testimony, so far as it sought to establish them, clearly indicated that those interested in BancoKentucky in good faith believed that it was a sound financial institution and that the principles upon which it was organized and was being conducted would prove profitable to its stockholders. But, if it were otherwise as to element 2, then it is quite clear that element 3 was not proven, since Mr. Thiemann, with whom defendant conversed, and who was the sole officer of the National Bank of Kentucky whom she consulted, was enthusiastic over the prospects for the success of BancoKentucky, in which, we repeat, he had made a large individual investment."

The Mr. Thiemann referred to in the Beck case was the same Mr. Thieman upon whose word Mr. Tway relied. His good faith has been conceded in this case (R. 127, 352, 348).

CONCLUSION.

A very peculiar situation is revealed by the record in this case. Tway was named as defendant in two separate suits brought by the Receiver. One was the action for stock assessment resulting from his ownership of Banco stock and the other was on the note given to the Bank. In the stock assessment suit, Tway successfully maintained in this Court that:

> "Banco was organized in good faith and was not a sham; * * * It was not organized for a fraudulent purpose or to conceal enterprises conducted for the benefit of the Bank; * * * It was not a mere holding company; * * * It was not formed as a means of avoiding double liability on the stock of the Bank; and * * * the soundness of the Bank and its ability to meet the obligations could not be questioned until after the formation of Banco." Anderson v. Abbott, 321 U. S. 349.

In the stock assessment case, Tway obtained a finding that "Banco was formed for the purpose set out in the letter of July 19, 1929, and for no other purpose." (Finding of Fact No. 65, R. 1, p. 267, Anderson v. Abbott No. 3, October Term, 1943.) In the note case, Tway affirmatively alleged in his answer that the letter of July 19, 1929 "* * * does not set forth what was in truth and fact the reason why the Bank organized said Company (R. 16). * * * The BancoKentucky Company was organized by the Bank for the purpose of procuring this defendant and others to

subscribe for stock of the BancoKentucky Company to pay for same in cash, in order that the Bank, being in control of the said BancoKentucky Company, might take the funds of the BancoKentucky for worthless claims carried by the Bank amongst its assets" (R. 21).*

The allegation above set forth, which is diametrically opposed to the position taken by Tway in the assessment suit was repeated seven times in Tway's answer (R. 16, 20, 21, 25, 28, 29, 31). It is a statement introductory to twenty-three pages of the answer which set out alleged facts in support of the introduction. It was one of the matters submitted to the jury. The Court charged it:

> "One of the matters relied upon as a defense is that the organization of Banco in its inception was for the purpose and design and plan which contemplated the removal from the assets of the National Bank of Kentucky certain items that had been criticized by Bank Examiners and which have been specifically pointed out in the trial of this case as having been concealed from the defendant Tway" (R. 1216).

In the Court of Appeals, Tway contended "that he did not rely upon the allegation that Banco was organized for the purpose of removing bad assets from the Bank" (R. 1365). Judge Simons pointed out, however, that "that issue was, however, submitted to the jury and there can be no doubt that the evidence bear-

*The Receiver pleaded that Tway was estopped to take diametrically opposite positions in the two suits (R. 53) on the ground that a "fact once so determined as between the same parties or their privies, must be taken as conclusively established." (Southern Pacific R. R. v. U. S., 168 U. S. 1.)

ing thereon was prejudicial." The majority opinion does not refer to this phase of the case. It would seem that the waiver alone of reliance on a claim submitted to the jury—a point previously adjudicated in litigation between the same parties, in favor of the Receiver, would justify a new trial, so that the jury can consider the facts without being influenced, as they must, by a charge of this nature.

A further unique situation is presented by the nature of the opinion written in the Appellate Court. Judge Simons points out ~~three~~ seven separate errors in the action in the District Court proceedings. The majority opinion only gives its reasons for disagreement with Judge Simons as to one of those errors.

Judge Simons points out:

1. That Tway should not have been permitted to establish losses by Banco resulting from acts independent of the vice of which he complains and involving transactions entered into after he bought his stock. "Neither Thieman nor the Bank was a guarantor of the financial successes of the Banco venture and neither could be charged with knowledge of future events (R. 1364) * * * I arrive at the conclusion that the operations of Banco subsequent to Tway's purchase of its stock were inadmissible as evidence, and that such manipulations as were permitted to go to the jury, even though not now relied upon by Tway, were so prejudicial to the rights of the Receiver as to require a new trial" (R. 1365, 1366). The majority of the Court did not comment on this phase of the case.

2. "The Receiver should have been permitted * * * to demonstrate error in the allegations of his pleading" (R. 1364). There was no comment from the other judges.

3. That the hearsay statements contained in the Examiners' Report could not "be legitimized as evidence merely by including it in an official report" (R. 1365). The majority opinion did not comment on this matter.

4. That Tway could not eliminate prejudice by waiving in the Appellate Court his contention that Banco was organized for a wicked purpose. "Tway now contends that he did not rely upon the allegation that Banco was organized for the purpose of removing bad assets from the Bank. That issue was, however, submitted to the jury and there can be no doubt that the evidence bearing thereon was prejudicial * * *. Nor does Tway's present repudiation * * * cure the prejudice which Brown's washed sales and subterfuge must have created in the minds of the jury" (R. 1365). The majority opinion does not reply to this statement.

5. That Tway's participation in an *ultra vires* transaction was a defense if he "knew" that it was "beyond the authority of the Bank" (R. 1367-8). The majority of the Court did not disagree on this comment.

6. That the instruction, with relation to the Chicago brokers' subscription for 250,000 shares of Banco stock "would probably be avoided upon retrial (since) in view of the conceded good faith of Thieman it was erroneous

and clearly prejudicial * * * the jury should not have been allowed to consider the statement as an element in the alleged fraud" (R. 1369). The majority of the Court did not disagree with this statement, but, nevertheless, did not order a new trial, so that this "erroneous and clearly prejudicial" instruction could "be avoided upon retrial."

7. That the verdict was bottomed on testimony given by Tway in the trial below, which was "concededly untrue" (R. 1371) and that the jury should have a right to appraise Tway's credibility in the light of the newly discovered evidence for the reason that he was the sole witness on material factors in the case. The majority of the Court only commented on this phase of the case and accepted Tway's position that he had never "purchased the stock individually" (R. 1372).

It is agreed, therefore, by all judges that Tway's testimony in the trial that he owned the stock, was untrue, but, the other Judges nevertheless, refused to join in with Judge Simons in directing a new trial.

It is submitted that the proceedings below represent a departure from the accepted and usual course of judicial proceedings and call for the exercise by this Court of its powers of supervision.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1944.

A. M. ANDERSON, Receiver National Bank of Kentucky, - - - - - - - - Petitioner,

versus

R. C. TWAY, - - - - - - - - Respondent.

RESPONSE OF R. C. TWAY, RESPONDENT, TO PETITION FOR WRIT OF CERTIORARI AND TO BRIEF IN SUPPORT OF SUCH PETITION.

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IN THE

Supreme Court of the United States

October Term, 1944.

A. M. ANDERSON, RECEIVER NATIONAL BANK OF KENTUCKY, - - - - - - - *Petitioner,*

v.

R. C. TWAY, - - - - - - - - *Respondent.*

RESPONSE OF R. C. TWAY, RESPONDENT, TO PETITION FOR WRIT OF CERTIORARI AND TO BRIEF IN SUPPORT OF SUCH PETITION.

GROUNDS ON WHICH PETITIONER SEEKS CERTIORARI.

The petition is bottomed upon the claim that certain rulings of the trial court, sanctioned by the Circuit Court of Appeals, constituted such a departure from the accepted and usual course of federal judicial procedure as to demand review by this Court.

The rulings complained of in the petition are:

(1) The admission in evidence of certain reports of examinations of the National Bank of Kentucky made by national bank examiners.

(2) The admission in evidence of certain parts of a bill in equity filed by the Receiver against the bank's directors.

(3) The admission in evidence of a table of earnings of the bank prepared by an accountant employed by the Receiver.

(4) Refusal to grant a new trial on alleged newly discovered evidence.

(5) Refusal to submit to the jury the Receiver's defense of *ultra vires.*

(6) Refusal of the trial court to hold that Tway could not plead the fraud practiced upon him as a complete defense to the note, but that in this action his only remedy was to assert the fraud in a counterclaim offsetting his liability on the note by the amount of damages, if any, the jury might find for him on the counterclaim.

We assume that the Court will not grant the Writ unless it appears reasonably probable that the case presents some substantial and important questions of law not heretofore passed upon by this Court; and that in the determination of whether such questions are presented, the Court will examine not only the petition, but the response thereto as well. On that assumption, we shall attempt to demonstrate not only that there are no such questions in this record, but that the petition is not even characterized by that candor and sincerity which should characterize such an application.

Before proceeding to a discussion of the six grounds relied upon by petitioner, a short preliminary statement of facts is deemed necessary.

PRELIMINARY STATEMENT.

The Receiver of the National Bank of Kentucky sued Tway to recover judgment on his promissory note executed to the bank about a year before the failure of that institution. Tway's defense was that in the prosecution of its campaign to sell and distribute the capital stock of BancoKentucky Company, a corporation which the bank caused to be organized and promoted and in the success of which it was vitally interested, the bank, by positive misrepresentations and by the concealment of and failure to disclose material facts, induced him to purchase Banco stock and execute and deliver the original of the note sued on for the amount of the purchase price of the stock, which amount the bank, as an inducement to Tway to make the purchase, agreed to lend him on the sole security of the stock.

The story of the organization of BancoKentucky Company, and of the activities of the National Bank of Kentucky in connection therewith, was before this Court in the case of *Anderson, Receiver* v. *Abbott,* 321 U. S. 349, in which case the Court, in speaking of the organization of Banco, said:

> "It was organized by the management of the National Bank of Kentucky and of Louisville Trust Company—banking houses doing business at Louisville. Banco perfected the desired alliance between them by acquiring most of their shares in exchange for its shares. The bank, the trust company, and Banco each had the same directors and certain common officers."

As this Court doubtless learned from the record in that case, and as is fully disclosed by the record in the case at bar (R. 8, 9, 235, 769), Banco had an authorized capital of 2,000,000 shares of the par value of $10 per share. Under the plan promoted by the bank, that stock was marketed at $25 per share, the purpose being to give the company a capital of $20,000,000 and a surplus of $30,000,000. The plan under which Banco stock was exchanged for the stock of the National Bank of Kentucky assigned to the stock of the latter a value of $500 per share, and at the date Tway executed the original of the note sued on, October 1, 1929, $18,914,500 of the authorized capital and surplus of Banco was represented by National Bank of Kentucky stock exchanged at the price of $500 per share. This sum represented 95% of Banco's authorized capital of $20,000,000 and 38% of its combined capital and surplus of $50,000,000. Of course, in this situation the actual condition of the National Bank of Kentucky and the true value of its stock were vitally material elements in determining the value of Banco stock.

Prior to its receivership, the National Bank of Kentucky, by published financial statements which had been furnished to and read by Tway, represented that it had an unimpaired capital of $4,000,000, a surplus of $2,000,000 and undivided profits of $234,635.05 (R. 194, 195). It was regarded by the public, including Tway, as one of the strongest financial institutions of the South (R. 145, 147, 150, 151, 904, 907).

As a matter of fact, however, at the time Banco was organized and when the bank sold Tway the stock, that

institution was in a critical and failing financial condition. Indeed, its condition was a matter of such grave concern to the Comptroller of the Currency and his examiners that from 1927 until the failure of the bank in 1930, they almost constantly were urging the bank to get its financial house in order. Finally the demands of the Comptroller became so insistent that the officers of the bank, during the examination by the national bank examiners in May and June, 1929, just one month before the organization of Banco, induced the examiners to postpone their demand for a heavy charge off of slow and worthless loans by the assurance that it was proposed to organize a large holding company which would use its assets to take some of the criticized items out of the bank's portfolio, and by the further assurance that the bank intended to denationalize by surrendering its national charter and taking out a state charter, thus relieving the Comptroller of further responsibility for the financial integrity of the institution. In line with those assurances, the Board of Directors of the bank by two resolutions of June 7, 1929, and of June 21, 1929 (R. 501), authorized the organization of a corporation which turned out to be Banco, and on September 27, 1929 (R. 508), authorized the incorporation of the bank as a state institution, and thereafter procured a charter as such institution (R. 513, 514). It thereupon applied for membership in the Federal Reserve System as a state bank (R. 515) and upon the requirement of the Federal Reserve agent at St. Louis that the bank must submit to an examination before being admitted as a member of the System (R.

520), and must eliminate from its assets over $4,000,000 of its assets criticized in the May-June, 1929, examination, the bank abandoned its plan of denationalization and surrendered its state charter.

Tway executed three renewals of the original note, the last renewal being the one sued on, dated October 2, 1930, and at the time of each renewal he paid the interest to the date of the maturity thereof, the interest so paid aggregating in round figures $3,000 (R. 106, 107). Four quarterly dividends of $400 each were paid on the 2,000 shares of Banco stock, same being paid respectively in January, April, July and October, 1930 (R. 113). These dividends were all turned over to R. C. Tway Coal Sales Company, the real owner of the stock, and that company reported same in its 1930 Income Tax Return (R. 1295).

On February 2, 1931, the date of the maturity of the last renewal and after receivership, the Receiver, at the request of Tway, applied as credits on the note $4,031.74 of deposits, of which Tway was the owner, and at the same time Tway paid the Receiver the additional sum of $1,993.26, which resulted in paying interest on the renewal from October 2, 1930, to February 2, 1931, and in reducing the principal by the sum of $5,000. Thereafter on July 13, 1931, and on October 8, 1931, Tway made interest payments on the note to the Receiver aggregating $1,800. The total amount of interest and principal payments made by Tway on the note, including interest payments prior to receivership, was $10,883.33 (R. 107).

In the early part of 1931, the Receiver filed an action against the directors of the bank to enforce

individual liability against them for losses to the bank from mismanagement, and during October, November and December, 1931, the Receiver took a vast amount of proof in his action against the Directors, to establish the failing condition of the bank in 1927, 1928 and 1929 (R. 448, 449), and this evidence which included the reports of the bank's examinations during those years, unmistakably disclosed that the bank was in a precarious financial condition at the time it sold Tway the 2,000 shares of Banco stock. Tway first learned of the substance of this evidence in January or February, 1932, when informed thereof by his attorney (R. 240, 444, 445).

We shall discuss the six grounds upon which petitioner relies in his petition in the order heretofore stated.

1.

The Admission in Evidence of the National Bank Examiners' Reports.

Petitioner makes two contentions in respect to these reports: (a) that they were not admissible for any purpose as the examiners who made the reports were not produced as witnesses to vouch for their correctness and were not available for cross-examination; and (b) that much of the material in each of the reports is based upon the examiner's interrogation of, and reports to him from, the bank's officers, rather than upon the result of the examiner's own knowledge and observation, with the claimed result that the admission of the reports violated the rule against hearsay evidence.

Petitioner evidently realizes that this Court would hesitate to grant certiorari merely because of the admission of hearsay testimony, and therefore relies chiefly upon the claim that the admission of the reports as evidence illegally deprived him of his right of cross-examination and, hence, denied him due process.

The petition is silent on certain very material facts in respect of the admission of the examiners' reports. Those facts are:

(a^1) The authenticity of the reports was admitted.

(b^1) A copy of each of the reports was filed with the bank at the time same was made and was a part of the records of the bank at the time the Receiver took possession thereof, and he has had possession of them ever since.

(c^1) The Receiver had been in possession, not only of those reports, but of all the other records of the bank for approximately ten years at the time this action was tried, and had the assistance not only of a large force of employees, but of an independent firm of accountants, Lybrand, Ross Brothers and Montgomery, to ascertain the true condition of the bank (R. 659); and in all of the suits which have grown out of the failure of the bank, he has never challenged the correctness of the examiners' reports, but, on the contrary, they have been his chief reliance in his efforts to prove that the bank was in a failing condition for three years immediately prior to its failure.

(d^1) Each of the reports was introduced by the Receiver as evidence of the condition of the bank, and of the criticisms by the bank examiners and the Comp-

troller's office and of the other facts therein dealt with, in another action by this same Receiver against the respondent, Tway, and others, which action ultimately came before, and was decided by, this Court under the style of *Anderson, Receiver,* v. *Abbott, et al.,* 321 U. S. 349. The record in that case, including the same bank examiners' reports, on motion of the Receiver, was filed as an exhibit in this case (R. 1093, 1094). While the schedule in the case at bar called for the inclusion of the record in *Anderson, Receiver,* v. *Abbott,* we do not know whether it was included or not. At any rate, the record of that case is in this Court and the evidence covering the introduction of the reports is found in Vol. 2 of the Transcript of Evidence in that case, pages 140 to 182, both inclusive.

(e[1]) In *Anderson, Receiver,* v. *Abbott, et al., supra,* the Receiver used as witnesses to prove the correctness of the reports exactly the same witnesses he now insists Tway should have produced so as to afford him an opportunity, by cross-examination, to impeach those same reports—namely, the examiners who made the reports.

We submit that the foregoing facts fully justify the statement made near the beginning of this response that the petition is lacking in candor.

On the merits of the question, we believe the reports were properly admitted for two reasons: (first) having been introduced and vouched for by the Receiver in the other suit against Tway, they were competent in the case at bar as admissions against interest on the part of the Receiver; and (second), being of-

ficial records and reports required by law to be made, they were admissible as evidence of the facts therein stated.

(First) In the *Abbott* case, by offering the reports to prove the condition of the bank, the Receiver, in effect, asserted that they did correctly disclose its condition. Under a well settled principle of law, what he asserted as a fact in that case is competent as an admission in the case at bar. *Wigmore on Evidence,* Vol. 4, page 97, §1073, states the applicable rule:

> "The party's use of a document made by a third person will frequently amount to an approval of its statements as correct, and thus it may be received against him as an admission by adoption."

This rule is especially applicable where the prior use was against the party offering it as an admission by adoption in the later case. See also *People* v. *Burgess,* 244 N. Y. 472, 155 N. E. 745.

Not only did the Receiver introduce the examiners' reports in the *Abbott* case as evidence of the condition of the bank, he did exactly the same thing in the suit against the directors of the bank and was successful in having the Court accept those reports as evidence of its condition. In *Atherton* v. *Anderson,* 99 Fed. 2d 883, 889, the Circuit Court of Appeals for the Sixth Circuit used this language in respect of what those same reports disclosed:

> "National Bank Examiners made an examination semi-annually and forwarded their reports to the Comptroller of the Treasury, leaving a copy with the Bank. The record is replete with copies

of letters from the Comptroller's Office from 1919 until the close of the Bank concerning these reports. Some of these letters were addressed directly to the Board, others to the President, and others to various officers of the Bank. It is not practical here to go into detail touching the contents of either the letters or the reports. It is enough to say that the reports exhibited the ruinous condition of the Bank in general and of the Wagon Company account in particular and the Examiner's reports invariably criticized the handling of it and especially the excessive overdrafts."

The examiners' reports introduced by Tway in the case at bar were of examinations made on the following dates: April 23 to May 12, 1927; October 14 to October 29, 1927; March 9 to March 31, 1928; October 13 to October 27, 1928; May 25 to June 15, 1929; December 30, 1929 to January 11, 1930; April 26 to May 9, 1930; and September 17, 1930. In the *Abbott* record they are identified as plaintiff's Exhibits 13, 14, 15, 16, 17, 18 and 19, respectively.

The same counsel represented the Receiver in the *Abbott* case as represent him in this proceeding, and the utter lack of sincerity in the complaint that the petitioner was afforded no opportunity to show the unreliability of the examiners' reports through cross-examination of the examiners who made same, is probably best demonstrated by a consideration of their brief filed in this Court in the *Abbott* case. Pages 7 to 24 of that brief are devoted almost exclusively to a discussion of the condition of the bank at the time Banco was organized, as disclosed by the examiners'

reports beginning with the report of the examination of April-May, 1927, and ending with the examination of May-June, 1929, and by the correspondence between the Comptroller and the bank and its officials in respect of those reports. Those reports are the same ones introduced in Tway's behalf in the case at bar. That part of the brief opens with the following statement:

"FACTS OF THE CASE

"National Bank of Kentucky was in an unhealthy condition for three full years before it failed on November 16, 1930. Its financial condition grew worse gradually and was very bad in June, 1929, when BancoKentucky was organized, and even worse in October, 1929, when the bank shareholders exchanged their bank stock for BancoKentucky stock. It failed, and so did Banco, exactly thirteen months and sixteen days after the exchange was made.

"The above general statement is not argumentative. *It is supported by actual and uncontradicted written records of the National Bank of Kentucky introduced in evidence in this case and appearing in great detail in the record before this Court.*" (Brief, page 7.) (Emphasis ours.)

The brief then proceeds to discuss the condition of the bank as of the date of each of the examinations as disclosed by the report thereof. The discussion of each report is under a numbered heading which briefly summarizes the bank's condition as disclosed by that particular report. Those headings and excerpts from the discussion under each are interesting:

"1. National Bank of Kentucky's Financial Condition Unhealthy on April 23, 1927.

"National Bank of Kentucky was examined by the National Bank Examiners on April 23, 1927, which was more than three years before the failure. The examination was concluded on May 12, 1927. The Examiners' report was lodged with the Comptroller of the Currency. A copy of the report, as is customary, was promptly sent to the Board of Directors of the bank. * * *" (Brief, page 7).

"In spite of this unhealthy condition, or better perhaps because of it, National Bank of Kentucky, right at this time, went into a sort of partnership with Louisville Trust Company, a large state bank. Louisville Trust Company failed the same day National Bank of Kentucky failed, so it was a case of two weak brothers leaning on each other for support. * * *" (Brief, page 10).

"2. No Improvement in Its Condition During Next Six Months.

"The Bank Examiner's report of October 14, 1927 (Ex. V. 1, pp. 315 to 406), shows that the unhealthy condition existing six months previous (see pp. 7 to 10, *infra*) had not improved, notwithstanding 'unification' with Louisville Trust Company and the publicity attending the same. It requires substance to clean up a failing national bank. * * *" (Brief, page 11).

"3. National Bank of Kentucky's Condition at March 9, 1928, Shows That It Was Getting Worse.

"The Bank Examiner's report of the bank examination of March 9, 1928, showed a further decline in its financial position (Ex. V, 1, pp. 408 to 485). * * *" (Brief, page 14.)

"4. Bank's Condition Was Very Bad at October 13, 1928.

"A regular national bank examination was again held on October 13, 1928 (Ex. V. 2, pp. 486 to 571). This date is a little more than six months before BancoKentucky was organized and just about a year before the exchange of bank stock for Banco stock. * * *" (Brief, page 16).

"5. When BancoKentucky Was Promoted and Organized, National Bank of Kentucky Was in a Precarious Condition.

"A regular examination of the National Bank of Kentucky began on May 25, 1929, and consumed twenty-two days. This examination was conducted by the Chief National Bank Examiner (Ex. V. 2, pp. 572 to 652). During this examination the Chief Examiner discussed at length with the President and other officers the unsatisfactory condition of the bank (Ex. V. 2, p. 650). As a result of these conferences it was promised to the Examiner that a holding company would be formed, with new capital, and that the criticized assets would be taken out of the bank.

"National Bank of Kentucky at this time was in a deplorable condition, as its own records plainly show. Its condition at that time might well be said to be desperate. * * *" (Brief, page 18).

After quoting from the report a criticism of the Kentucky Wagon Manufacturing Company's loan, the brief continues:

"* * * The Bank Examiner discussed this and all other criticized assets with the officers of the bank. To save the situation the bank officials told the Examiner that, if he would waive the required and necessary charge-offs at this examination, a great holding company with new capital would be immediately organized to take Kentucky Wagon and all the other dead wood out of the bank. It is all in writing in the National Bank Examiner's May 25, 1929, report wherein it is stated:

"'Your examiner feels that the realizable value of this asset is so uncertain that the management of the bank should continue to make some substantial charges to Profit and Loss on account of it. The matter was discussed at some length at an officers' meeting. Your examiner was advised that a plan is in contemplation whereby a sort of a finance and holding company will be organized with a large capital stock, say twenty million dollars.

"'The holding company will hold, among other things, the stock of the National Bank of Kentucky and its affiliated bank through a surrender and exchange of stock of the bank for stock of the company on some satisfactory basis. It is also contemplated that the holding company

will acquire, and through a term of years work out, certain assets of the bank, among others, probably Kentucky Wagon Manufacturing Company. In view of the contemplated organization of the holding company, your examiner was requested to waive any charge to Profit and Loss at this time on account of the Kentucky Wagon Manufacturing Company loan. Your examiner suggested that the matter might be deferred until the next examination, provided the management of the bank would agree that if the Kentucky Wagon Manufacturing Company loan is not removed from the bank by the time of the next examination, a charge of $200,000.00 to Profit and Loss would be made on the loan. It later developed that the proposed plan of consolidation is likely to be consummated at an early date, hence the matter of charge off was dropped' (Ex. V. 2, p. 612).

"As to losses generally, the report states:

" 'The matter was discussed in meeting of officers. It was also discussed in a conference with President Brown. It is expected that the bank will be functioning as a State institution within ninety days. In view of this fact, the management requested that the matter of "charging off" losses be waived' (Ex. V. 2, p. 650).

"The examination was concluded June 15, 1929." (Brief, pages 21 and 22.)

Under each of the five headings above quoted the brief contains a more or less detailed recitation of the

contents of the particular report under discussion as to criticized assets and practices and the bank's condition generally, which fully justify the summary statement of its condition contained in each of such headings.

Probably the references to the exhibits contained in the quotations from the brief need an explanation. The references do not coincide with the exhibit numbers nor the pages of the record in the *Abbott* case. When that case was appealed, counsel for the Receiver had photostats of the exhibits bound into five volumes for the convenience of the Court, and the references in the above quotations are to those volumes of exhibits rather than to the certified record on appeal.

We respectfully submit that, having used the examiners' reports against Tway in the *Abbott* case, the Receiver may not object to their use by Tway for the purpose of proving the same facts the Receiver used them to prove in the *Abbott* case. Unquestionably, they were competent against the Receiver as admissions by adoption.

(Second) If for any reason it should be held that the reports were not competent as admissions by adoption, nevertheless, inasmuch as they were official records and reports required by law to be made, they were admissible without further proof as evidence of the facts therein stated and dealt with.

In the lower court the Receiver sought to avoid the admissibility of the reports as official reports and records by asserting that national banks are purely private institutions. Of course, this is not true. National

banks are institutions and instrumentalities of the National Government (Section 21, Title 12, U. S. C. A.). Their powers are carefully enumerated and limited; they have been granted the extraordinary power of issuing their notes, which are permitted to circulate as money (Section 109, Title 12, U. S. C. A.); and the Secretary of the Treasury is empowered to authorize them to act as depositories and fiscal agents of the Government (Section 90, Title 12, U. S. C. A.). They are subject twice each year, and oftener, if the Comptroller of the Currency so determines, to examination by national bank examiners appointed by the Comptroller. The powers and duties of national bank examiners in conducting such examinations are defined by statute as follows:

> "The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency." (Sec. 481, Title 12, U. S. C. A.)

According to regular practice and under regulations of the Treasury Department, copy of each report is filed with the bank under examination. Because of the fact that they are agencies of the United States Government and not private institutions, they are exempt from taxation in the states in which they conduct

their business except to the extent specifically authorized by Congress. *McCulloch* v. *Maryland,* 4 Wheat. 316; *New York ex rel. Williams* v. *Weaver,* 100 U. S. 539; *Mercantile National Bank* v. *New York,* 121 U. S. 138; *First National Bank of Gulfport* v. *Adams,* 258 U. S. 362; *Des Moines National Bank* v. *Fairweather,* 263 U. S. 103.

From the foregoing authorities, it would seem to inevitably follow that a copy of any such report, when properly identified, or when admitted to be a true copy as was done in the case at bar, is entitled to all the weight which the law gives to official reports and records made and kept in the performance of official duties.

The petition asserts (page 37) that the basis of the action of the trial court in admitting the reports was Sections 661 and 663, Title 28, U. S. C. A. As a matter of fact, the trial judge did not state that he relied upon those two sections, although Tway's counsel did argue that those sections, in connection with Sections 1636 and 1637 of Kentucky Statutes, as those two sections have been construed by the Court of Appeals of Kentucky, constituted sufficient authority for their admission. The court permitted the introduction of the evidence under the general rule applicable to the admission of public records and reports as evidence of the facts therein dealt with. That rule is thus stated in *American Jurisprudence,* Volume 20, page 861, Section 1023:

> "It is a well-recognized general rule that official records and written reports of a public nature

> which public officers are required, either by statute or by the nature of the duties of their office, to keep of transactions occurring in the course of their public service, made either by the officers themselves or under their supervision, are ordinarily admissible in evidence as proof of the facts recorded therein, so far as they are relevant and material to the particular inquiry, although the entries have not been testified to by the persons who actually made them and although they have, therefore, not been offered for cross-examination."

The rule is applicable not only to records kept and entries made in a public office, but to reports made by a public officer of an investigation of matters which the law makes it his duty to investigate and report. The same section of the same work states:

> "Records and reports of public officers made in the course of the discharge of their official duties are admissible not only as proof of the facts stated therein, but also to show the absence of entries that in the usual course should appear therein and to prove, by reason of the absence of any entry, that an event did not take place or that something was not done."

Wigmore on Evidence, Volume 5, page 672, Section 1670, in discussing the probative effect of the report of an investigation made by an official in the discharge of his duties, states:

> "A report is to be distinguished from a return, as already defined (*ante*, Sec. 1664), in that the latter is typically concerned with something done

> or observed personally by the officer, while the former embodies the results of his investigation of a matter not originally occurring within his personal knowledge. The older term customarily applied to the former type of statement—'inquisition' or 'inquest'—suggests more clearly its special quality, namely, that of resting upon means of information other than original personal observation.
>
> "Now an inquisition or report, if made under due authority, stands upon no less favorable a footing than other official statements. As a statement made under official authority or duty, it is admissible under the general principle."

In the petition, and throughout the course of this litigation, counsel for the Receiver has had much to say about the incompetency of that portion of a public official's report which is based upon information gathered from others, rather than upon his own observation and knowledge. But *Wigmore on Evidence,* Volume 5, pages 525 *et seq.,* Section 1635, punctures that contention. After stating that the *general* rule in respect of the competency of official records and reports excludes statements therein contained not based upon the personal knowledge or observation of the officer, the author points out that, where the law specifically requires or authorizes the official to ascertain the facts in whole or in part by an investigation or inquisition, his report of the facts obtained by such investigation or inquisition is competent under an exception to the general rule. The author states:

> "Now there may be cases in which the officer's duty clearly does involve his ascertainment of facts occurring out of his presence and requiring his resort to sources of information other than his own senses of observation; for example, an assessor's record of the value of real estate and of its occupancy, or a registrar of voters' record of electors' residences. When such a duty clearly exists, the general doctrine above, that a witness should have personal knowledge, need not stand in the way, for (as already noted) it has its conceded limitations; and where the officer is vested with a duty to ascertain for himself by proper investigation, this duty should be sufficient to override the general principle. It is true that due caution should be observed before reaching the conclusion that the law has in fact in a given case intended to invest the officers with such an unusual duty. But when it clearly appears that a duty has been prescribed to investigate and to record or certify facts ascertained other than by personal observation, then it follows that, in accordance with the general principle of the present exception, the statement thus made becomes admissible."

Of course, there can be no doubt that the law not only authorizes, but actually commands, national bank examiners to conduct such investigations or inquisitions, and report the facts so ascertained. The argument that public records and reports are competent evidence only of those facts therein reported as are within the personal knowledge and observation of the officer making such records and reports ignores the basis upon which public records and reports made and

kept in discharge of official duties are admitted as evidence of the facts therein stated. The reason for their admission is thus stated in *American Jurisprudence,* Volume 20, page 862, Section 1023:

> "Records of public officers are usually made by persons having no motive to suppress or distort the truth or to manufacture evidence, and, moreover, are made in the discharge of a public duty, and almost always under the sanction of an official oath. They form a well-established exception to the rule excluding hearsay. The exception rests in part on the presumption that a public officer charged with a particular duty has performed it properly. This is deemed sufficient to dispense with the necessity of oath and cross-examination. Since the records concern public affairs, and do not affect the private interests of the officers, they are not tainted by the suspicion of private advantage."

Gaines v. *Relf,* 12 How. 472, 570, states the reason in this language:

> "Such writings are admissible in evidence on account of their public nature, though their authenticity be not confirmed by the usual tests of truth; namely, the swearing and the cross-examination of the persons who prepared them. They are entitled to this extraordinary degree of confidence, partly because they are required by law to be kept, partly because their contents are of public interest and notoriety, but principally because they are made under the sanction of an oath of office, or at least under that of official duty, by accredited agents appointed for that purpose."

In *Chesapeake & Delaware Canal Co.* v. *United States,* 250 U. S. 123, 128, it is stated:

> "They were public records, kept pursuant to constitutional and statutory requirement. * * * Thus, their character as public records required by law to be kept, the official character of their contents entered under the sanction of public duty, the obvious necessity for regular contemporaneous entries in them and the reduction to a minimum of motive on the part of public officials and employees to either make false entries or to omit proper ones, all unite to make these books admissible as unusually trustworthy sources of evidence."

Wigmore on Evidence, Volume 5, page 514, Section 1632, in commenting on the adequacy of the reason for the rule, has this to say:

> "Nor is the adequacy of this traditional principle to be today discredited or doubted. Official honor may or may not be what it has been or what it ought to be, and it may differ in different communities and persons. But, in the matters with which the law of Evidence is concerned, official duty is on the whole a vital force, more potent than might be supposed, even in a community where official ceremony and dignity are as little regarded as with us. And even if the traditional assumption of the potency of official duty and honor be in some regions or for some classes of incumbents more a fiction than a fact, it is at least a fiction which we can hardly afford in our law openly to repudiate."

In view of the reason underlying the rule, what difference can it possibly make whether the facts recorded in the report reflect the officer's own observations or were ascertained by him as the result of inquiry and investigation? It will not be presumed that a public officer will do his duty and faithfully and truly record what he personally knows and observes, but will not faithfully and truly record what he has ascertained by an investigation which the law has commanded him to make.

In *Grant Bros. Construction Co.* v. *United States,* 232 U. S. 647, it was held that the report of a special board of inquiry appointed by an immigration inspector to inquire into whether certain persons were alien contract laborers, was competent evidence on that question in a penal action to recover the statutory penalties for having illegally imported contract labor into the United States. Of course, such a report was based upon an inquisition which developed facts of which the members of the board had no personal knowledge.

It has been held that certified copies of United States census reports are competent evidence of the age of a person, notwithstanding the obvious fact that the census enumerator is compelled to rely in most cases upon the word of others as to matters of age, name, etc. *Priddy* v. *Boice* (Mo.), 99 S. W. 1055. To the same effect see *Levels* v. *St. Louis & H. R. Co.,* 196 Mo. 622; *Stoddard* v. *Williams,* 64 Cal. 91; *Flora* v. *Anderson,* 75 Fed. 217, 231.

The petition (page 10) is especially critical of the admission in evidence of that part of the report of the examination of May-June, 1929, to the effect that in order to induce the examiner to postpone his demand for heavy charge-offs of slow, doubtful and worthless paper, the bank and its officers represented to him that a plan was in contemplation for the organization of a holding company which would take out of the bank the criticized assets, and also that a plan was on foot to denationalize the bank. We assume it will not be denied that a national bank examiner, under his broad powers and duties under Section 481, Title 12, U. S. C. A., heretofore quoted, has the right, and it is his duty, upon examination of a national bank to recommend that doubtful, slow and worthless assets should be charged off to the end that the financial statements of the institution will reflect its true condition. If the bank and its officials should refuse to accept such a recommendation, it would undoubtedly be the duty of the examiner to report the facts to his superior. Now, if it is his duty to report a refusal on the part of the bank's officials to make a charge-off when recommended by him, why isn't it his duty also, if his report shows doubtful, slow and worthless assets, to report to his superior why he failed to demand that they be charged off? That was exactly the situation dealt with in the examiner's report of May-June, 1929. His report showed a large amount of doubtful, slow and worthless assets. It showed that he had recommended a charge-off and that same was not made. He then proceeded, as unquestionably was his duty to do, to

explain and justify to the Comptroller why he agreed to postpone the enforcement of his demand for charge-offs. Furthermore, the promise of the officials of the bank reported by the examiner to his superior was damning proof of the condition of the bank. It displayed a willingness on the part of the officials not only to organize another corporation and use its funds to take criticized assets out of the bank, but to also denationalize, rather than to submit to a charge-off which would have materially impaired the surplus of the bank.

In addition to the reports being admissible in their entirety under the general rule applicable to official records and reports, we invite attention to Sections 661 and 663, Title 28, U. S. C. A.:

Section 661—

"Copies of any books, records, papers or documents in any of the executive departments authenticated under the seals of such departments, respectively, shall be admitted in evidence equally with the originals thereof."

Section 663—

"Every certificate, assignment, and conveyance executed by the Comptroller of the Currency, in pursuance of law, and sealed with his seal of office, shall be received in evidence in all places and courts; and all copies of papers in his office, certified by him and authenticated by the said seal, shall in all cases be evidence equally with the originals. An impression of such seal directly on the paper shall be as valid as if made on wax or wafer."

Of course, we appreciate that these statutes are susceptible of the construction that they authorize the use of authenticated copies in evidence only to the same extent that the originals thereof may be used, and do not authorize their use as evidence of the facts therein stated. However, there is ample statutory authority for the admission of these reports as evidence of the facts therein stated independently of the two sections of the Federal Statutes therein quoted. Sections 1636 and 1637 of Kentucky Statutes read as follows:

Section 1636—

> "All records and exemplifications of office books kept in any public office of the United States, or of a sister state, not appertaining to a court, *shall be evidence* in this state if attested by the keeper of such record or books, and the seal of his office, if there be a seal." (Emphasis ours.)

Section 1637—

> "Exemplifications from the books of the executive department of the United States, or any papers filed therein, *shall be evidence* when attested by the president or the chief of either of the departments; or from any state or territory, of like books or papers when attested by the governor or the secretary of state thereof, under his official seal." (Emphasis ours.)

Rule 43 of the Federal Rules of Civil Procedure, in substance, provides that all evidence which is admissible under the statutes of the United States, or under the rules of evidence heretofore applied in the courts of the United States in equity proceedings, or which is

admissible under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States Court is held, shall be admitted, and that:

> "In any case, the statute or rule which favors the reception of the evidence governs and the evidence shall be presented according to the most convenient method prescribed in any of the statutes or rules to which reference is herein made."

The Court of Appeals of Kentucky has decided that under those two sections of Kentucky Statutes, records of an office of the Executive Department of the United States Government are competent evidence of the facts and matters therein stated. *Huffman* v. *National Surety Co.,* 244 Ky. 714, 51 S. W. 2d 950; *Anderson* v. *Commonwealth,* 143 Ky. 87, 136 S. W. 134. It would seem, therefore, that, independently of the general rule applicable to the admissibility of the reports of public officers made in the discharge of their statutory duties, Rule 43 of the Federal Rules of Civil Procedure required the admission of the reports under Sections 1636 and 1637 of Kentucky Statutes as construed by the Court of Appeals of that state.

The petition complains that many of the matters dealt with in the reports were hearsay in that the examiner was merely reporting what the bank officials told him, and that those matters could have been competently proven only by the testimony of the examiner. This contention appears ridiculous to us. If the matters as recorded in the reports are to be condemned as hearsay, wouldn't the same objection be available

against the oral testimony in court of the examiner concerning the same matters? Of course, they were not hearsay, coming second-hand to the examiner; but were direct statements from the bank's officials to the examiner, and the report of them was within the scope of, and a part of, the examiner's statutory duties, and admissible without further proof under the general rule heretofore referred to.

2.

The Admission in Evidence of Certain Paragraphs of the Receiver's Bill Against the Bank's Directors (Anderson, Receiver, v. Atherton, Et Al.).

The Receiver argues (Petition, pp. 43, 44) that this evidence was not competent as an admission against interest; and if it was, the court committed error in refusing to permit him to put in evidence the final opinion and decree in that case holding that some of the allegations were not sustained by the proof. *A sufficient answer to the latter part of the contention is that it was not finally judicially determined that any of the paragraphs of the bill which were read to the jury were not sustained by the evidence.* Pages 701 to 723 of the Record discloses the paragraphs of the bill which were read to the jury and we state categorically that it was not judicially determined in that case that the allegations contained in those paragraphs had not been established by proof. See *Atherton, et al.,* v. *Anderson, Receiver,* 99 Fed. 2d 883. The mistake that the Receiver makes is that he has gone on the assumption

that all the paragraphs of the bill were read to the jury, which is far from true.

Now, as to the admissibility of the paragraphs which were read to the jury.

Whatever may have been the ancient rule as to the right of a party to introduce in evidence as an admission allegations contained in an unverified bill of complaint in some other action, it is now well settled that such allegations are competent as admissions, if it is shown that by his conduct the party in whose behalf the unverified bill of complaint or petition was filed adopted such allegations as his own. Under the modern rule verification is important only as showing that the party sought to be charged with such allegations had knowledge of same. In the absence of verification knowledge may be established by other evidence. For instance, if it is shown that during the progress of the trial the party sought to be charged with knowledge of the allegations, relied upon and urged same, he is presumed to have adopted the allegations as his own. *American Jurisprudence,* Volume 20, page 536, Section 634, states the rule in this language:

> "The failure to verify a pleading may be material in respect of the admissibility of the pleading in behalf of the pleader, but the sound rule appears to be that the verification of a pleading is not a prerequisite in all cases to the admission in evidence against the pleader of a statement therein. Many of the decisions which hold that admissions in unverified pleadings are not admissible either in the case in which filed or in other cases may be explained upon the ground that the state-

ments in the pleading were regarded as the statements of counsel rather than the statements of the party. Formerly, pleadings were so involved and technical that the mere fact that a pleading was filed in behalf of a party was not sufficient to warrant an assumption that the statements therein were his statements. Consequently, verification was considered essential to the admission of statements in a pleading against the pleader, the theory being that a pleader was not charged with knowledge of the contents of his pleading unless he had verified it. The modern view appears to consider the verification of a pleading as only one method of charging the pleader with the contents of his pleading; accordingly, the statements in a pleading are not rendered inadmissible against the pleader by the fact that he did not verify the pleading or that there was an irregularity in his verification, if it appears that he authorized the allegations, signed the pleading, or otherwise approved the allegations thereof after it was drawn."

In *Rockland* v. *Farnsworth,* 89 Me. 481, 36 Atl. 989, it is stated:

> "The doctrine seems to be settled that pleadings in another suit may be used as admissions of the party, where they bear upon the material issues on trial and appear to have been made by his direction or adoption, shown by prosecuting the action upon them, as the foundation of his claim."

In *Wilkens* v. *Clawson* (Texas), 110 S. W. 103, we find this statement:

"Statements in pleadings are admissible in evidence against the party filing such pleading, without regard to whether the pleading is sworn to. It is always competent for the party against whom the pleading is offered to show that the statement was inadvertently made, or was not authorized by him, or made under a mistake of fact. Such explanation may weaken or destroy the force of the statement in the pleading, but that is a question for the jury, and affects the weight, not the admissibility, of the pleading as evidence."

To the same effect see:

Lamar v. Pearre, 90 Ga. 377, 17 S. E. 92;
Every v. Rains, 84 Kan. 560, 115 Pac. 114;
Ayres v. Hartford Fire Ins. Co., 17 Ia. 176;
McTyer v. Stearns, 142 Ga. 850, 83 S. E. 955;
Schmisseur v. Beatrie, 147 Ill. 210, 35 N. E. 525;
Coward v. Clanton, 94 Cal. 23, 21 Pac. 359;
Nicholson v. Snyder, 97 Md. 415, 55 Atl. 484;
Brown v. Jewett, 120 Mass. 215;
Bliss v. Nichols, 12 Allen (Mass.) 443;
Dowzelot v. Rawlings, 58 Mo. 75;
Kunglig Jarnvagsstyrelsen v. Dexter & Carpenter, 32 Fed. 2d 195 (2d Cir.);
Carpenter v. Tri-State Telephone & Telegraph Co. (Minn.), 211 N. W. 463;
First Nat'l Bank v. Wisdom's Exr., 111 Ky. 135, 63 S. W. 641.

The pleading containing the admission is admissible against the pleader even though offered in behalf of a stranger to the action in which the pleading was filed.

Pope v. Allis, 115 U. S. 363;
General Electric Co. v. Clark & Sons, 108 Fed. 170;
Schmisseur v. Beatrie, 147 Ill. 210, 35 N. E. 525;
Ring v. Gray, 6 B. Mon. 368;
Swift & Co. v. Dawson Papershell Pecan Co. (Ga.), 101 S. E. 754;
Harris v. Amoskeg Lumber Co., 101 Ga. 641, 29 S. E. 302;
Lamar v. Pearre, 90 Ga. 377, 17 S. E. 92;
Humphrey v. Monida Stage Co. (Minn.), 131 N. W. 498;
Bergman v. Solomon, 143 Ky. 581, 136 S. W. 1010.

The statement in the petition (pp. 26, 27) that the Court of Appeals of Kentucky, in *Rankin* v. *Maxwell*, 9 Ky. 488, had condemned the admission in evidence of an unverified bill in equity is true so far as it goes; but that case was decided in 1820, in the days of involved and technical chancery pleadings, and simply followed the generally accepted rule at that time that such a pleading, nothing else appearing, could not be regarded as a statement by the litigant himself. With the simplification of pleadings in Kentucky, there ceased to be any reason for the rule, and it is now the settled rule in that state that a litigant may introduce the allegations of his adversary in some prior suit, though not between the same parties, as an admission against interest. *First National Bank of Paducah* v. *Wisdom's Ex'r*, 111 Ky. 135, 63 S. W. 641; *Bergman* v. *Solomon*, 143 Ky. 581, 136 S. W. 1010.

The Receiver has never repudiated any of the allegations of the bill which were read to the jury, nor

does he claim that they were made without his knowledge or approval. On the contrary, they formed the basis of all of his claims in the directors suit and, measured by the rule laid down in the foregoing authorities, those allegations were competent as admissions against him in the case at bar. The trial court did not deny, or even intimate an intention to deny, the right of the Receiver to controvert any or all of them. The fact about the matter is that the Receiver had no desire even to attempt to controvert them. He knew he could not do so. He is simply seeking on specious grounds to secure a new trial in a case which he lost on the strength of his own records which he had effectively used in other cases against his adversaries, including Tway.

The complaint of the Receiver about the admission in evidence of the paragraphs from the bill appears all the more trivial and insincere when we learn from the record that he, himself, introduced a copy of the Courier-Journal of March 31, 1939, containing a complete copy of the bill, and his counsel questioned Tway in respect of the allegations thereof (R. 419-433). Later on, counsel for the Receiver, when questioned by the Court, admitted that he had placed the bill in evidence (R 621). This was before Tway's counsel had read any part of the bill to the jury, which was done at the conclusion of Tway's case in chief (R. 701).

3.

The Admission in Evidence of a Table Comparing the Net Earnings of the Bank With Dividends Paid, Prepared by an Accountant Employed by the Receiver and Used by the Receiver Against Tway in Another Suit.

The statement, the admission of which was complained of, was defendant's Exhibit No. 61 (R. 567), which showed that the bank was frequently paying dividends in excess of its current earnings. The trial court admitted only that part of the statement covering the period from June 20, 1927, to and including September 30, 1929, the latter date being only one day before Tway purchased the stock and executed his note for the purchase price. This statement had been prepared from the books of the bank in the possession of the Receiver by an accountant employed by him for that purpose, and had been introduced by the Receiver in the *Abbott* case as a correct summary made by his own employee of the information contained in the Receiver's own records.

We feel that it is unnecessary to say anything further in demonstration of the lack of merit in this contention of the Receiver.

4.

Refusal to Grant a New Trial on Alleged Newly Discovered Evidence.

We believe a recitation of the facts in respect of this contention of the Receiver will demonstrate its lack of good faith. After the jury returned a verdict in favor of Tway, counsel for the Receiver, among other motions, filed one for a new trial on the ground of newly discovered evidence. This motion was based upon the affidavit of one of counsel for Receiver and on the affidavit of the assistant to the Receiver that the case had been tried by the Receiver under the impression that Tway had purchased the stock for his own account; that after the trial the Receiver and his counsel, for the first time, discovered that Tway had not bought the stock for his own account, but for the account of R. C. Tway Coal Sales Company, a corporation substantially all of whose stock was owned by Mr. Tway; that, therefore, the fraud, if any, had not been committed against Tway, but against the corporation, and that as Tway, individually, had sustained no damage as a result of such fraud, he could not plead fraud as a defense to the suit on his note (R. 1234-1243).

When this motion was argued before the trial judge Tway's counsel showed by the authorities that, even though Tway had bought the stock for the account of an undisclosed principal (which in fact he did), nevertheless, when sued on the note all the defenses were available to him which would have been available to

his principal, had the principal itself bought the stock and executed the note, and had the suit been against the principal alone. Thereupon, counsel for the Receiver, in the middle of the hearing, immediately shifted their position and claimed that the newly discovered evidence would show that Tway had bought the stock for himself and thereafter had sold it without loss to the company, and hence could not plead fraud when sued on the note (R. 1252, 1262-1297, 1298).

The Receiver claimed that it would be necessary to take the depositions of the defendant, Tway, and C. H. Clark, to develop the alleged facts (R. 1248). Tway's counsel agreed to make both Tway and Clark available for examination by counsel for the Receiver and to have the books and the records of the R. C. Tway Coal Sales Company present for examination and use in the interrogation of the witnesses. Counsel for the Receiver, on the day appointed, examined the books and records and then announced that they did not desire to take the deposition of either Tway or Clark, both of whom were present, and ready to submit to examination (R. 1232-1264).

The facts as to who was the real purchaser of the stock were developed before the lower court by affidavits appearing at pages 1266 to 1296 of the record, and the memorandum of the court denying the motion for a new trial on the ground of newly discovered evidence, either as at first advanced or as later urged, is set out in full at pages 1296 to 1299 of the record, the Court concluding that the evidence relied upon by the Receiver to establish that Tway originally bought the

stock for himself was so trivial as not to justify submitting the question to the jury, even if it was of any materiality. On that point the Court said (R. 1298):

> "As I view the evidence submitted on this question, which is in the form of affidavits and excerpts from the material corporate records, it is not reasonable to believe that the jury would have, or that any other jury would find that the defendant was the first owner of the stock in his own right. All of the circumstances surrounding the transaction as of the dates involved, which are in the record, would negative the idea that the defendant was so acting. The circumstances would clearly exclude any motive for a transfer under such circumstances. It would be futile to retry the case simply to submit to the jury this question of fact with so little to support the plaintiff's contention and so much to support the defendant's contention."

Of course, the question of whether Tway bought the stock for his own account or for an undisclosed principal was wholly immaterial. The note sued on was a negotiable instrument and it is a well-settled principle of law that an undisclosed principal cannot be sued on such an instrument executed and signed only by his agent, but that the agent alone can be sued and, when so sued, all the defenses are available to him as would have been available to the principal had he executed the note and been sued thereon. *American Jurisprudence,* Volume 2, page 312, §397, states the rule:

> "There is, *in the case of negotiable instruments* a generally recognized exception to the general rule that an undisclosed principal may, when discovered, be sued upon contracts made by his agent. It may be stated as a general rule that an undisclosed principal can not be held liable upon a *negotiable instrument signed or endorsed by his agent alone,* as each party taking a negotiable instrument contracts with the parties who upon the face of the instrument are bound for its payment." (Emphasis ours.)

The Kentucky Negotiable Instruments Law, Kentucky Revised Statutes, §356.018, Carroll's Kentucky Statutes, §3720b-18, which, of course, is controlling in this case, provides:

> "No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise provided. But one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name."

The statute contains no applicable exception. Rule 17(b) of the Federal Rules of Civil Procedure in part provides:

> "The capacity of an individual other than one acting in a representative capacity to sue or be sued shall be determined by the law of his domicile."

This rule is but supplementary to the Conformity Act (§725, Title 28, U. S. C. A.).

It is perfectly apparent, therefore, that under the general law and under Kentucky Negotiable Instruments Law, had the petitioner known at the time he filed his suit what he claims to have discovered after the trial, nevertheless he could have sued no one on the note except Tway. The defenses available to Tway are thus stated in the *Restatement of the Law of Agency,* §334, at page 738:

> "In an action against an agent upon a contract between a third person and the principal to which the agent is a party, the agent has all the defenses which arise out of the transaction itself and those which he personally has against the third person; defenses which are personal to the principal are not available to the agent."

The comment which follows the above statement makes the meaning of the statement perfectly clear. It reads as follows:

> "Defenses to the action arising out of the transaction itself, such as fraud, misrepresentation, recoupment, breach of condition, nonperformance, and the like, as well as payment and accord and satisfaction, will be available to the agent together with defenses, such as infancy or set-off, which the agent himself may have against the third person. If a contract results from misrepresentations of the third person to the principal, an agent without notice of their untruth has the same defense as the principal would have in an action against him; if the agent colludes in deceiving the principal, the transaction is illegal and the contract is unenforceable by the third person against the agent.

> "On the other hand, defenses resulting from personal incapacities or immunities of the principal, as where the principal is an infant or has become bankrupt, are not open to the agent."

It is clear from the foregoing authorities that the question of the actual ownership of the Banco stock was a wholly immaterial one, and the Receiver is left finally to the ridiculous contention that this Court should grant certiorari because the trial court refused to give him an opportunity on a new trial to discredit all of Tway's testimony by showing that he had falsely sworn that he was personally the purchaser and owner of the Banco stock. Furthermore, from a reading of Tway's cross-examination (appearing in the record at pages 293 to 307), so much relied upon by the Receiver as evidence of a false statement on the part of Tway that he was the owner of the stock, it will be found that those answers of Tway were the climax of an attempt by counsel for the Receiver to show that before Banco's collapse Tway could have sold the stock at a profit. The questions sought to draw answers from Tway showing that he was in a position for himself (or for his Company) to make delivery of the stock to a purchaser, although when he pledged the stock to the bank on the note, he had attached to the stock the usual authority enabling the bank to sell same in case of default on the note. The questions were not directed to the point whether the stock was owned individually by Tway or his corporation, but rather to whether he knew the bank did not own it and to Tway's ability

to make sale and delivery thereof. We believe a careful reading of the cross-examination will satisfy any one that Tway was not wilfully trying to deceive counsel for the Receiver as to who owned the stock.

5.

Refusal to Submit to the Jury the Receiver's Defense of Ultra Vires.

The contention of the Receiver on this point is that the action of the bank in selling the stock to Tway was *ultra vires* and, inasmuch as Tway was the purchaser of that stock and charged with knowledge of the fact that the bank could not validly sell stock of Banco, he was, therefore, a participant in the *ultra vires* act of the bank and could not avail himself of the defense of fraud.

We have no quarrel with the rule that *ultra vires* contracts of corporations are unenforceable, but the fallacy in the Receiver's contention is that it wholly overlooks the fact that Tway is not trying to enforce any contract executed by the bank in excess of its powers. On the contrary, he is repudiating the entire transaction.

Federal and state courts alike, without exception, hold that corporations, including national banks, are answerable for every wrong they commit, and that in such cases the doctrine of *ultra vires* has no application. *National Bank* v. *Graham,* 100 U. S. 699, 702, states the universal rule:

"Corporations are liable for every wrong they commit, and in such cases the doctrine of *ultra vires* has no application.

"They are also liable for the acts of their servants while such servants are engaged in the business of their principal, in the same manner and to the same extent that individuals are liable under like circumstances. * * * An action may be maintained against a corporation for its malicious or negligent torts, however foreign they may be to the object of its creation or beyond its granted powers. It may be sued for assault and battery, for fraud and deceit, for false imprisonment, for malicious prosecution, for nuisance, and for libel."

See also *Salt Lake City* v. *Hollister,* 118 U. S. 256, 260; *National Bank* v. *Anderson,* 172 U. S. 573; *Gas Light Co.* v. *Lansden,* 172 U. S. 534, 544; *Greeley National Bank* v. *Wolf,* 4 Fed. 2d 67 (8th Cir.); *Wasmann* v. *City National Bank of Knoxville,* 52 Fed. 2d 705 (6th Cir.); *In re Kentucky Wagon Manufacturing Company,* 71 Fed. 2d 802, 804 (6th Cir.).

In every *ultra vires* act of a corporation dealing with another party, out of which such other party assumes some obligation, of course it can be said that such party was an actor or participant in the *ultra vires* act of the corporation, and the rule contended for by the Receiver would result in permitting the corporation to enforce such obligation, even though same was obtained by the grossest fraud on the part of the corporation or its agent.

Such cases as *Deitrick* v. *Greaney,* 309 U. S. 190, and *D'Oench, Duhme & Co.* v. *Federal Deposit Insur-*

ance Corporation, 315 U. S. 447, relied upon by the Receiver, have no application whatever. In *Deitrick* v. *Greaney,* a national bank had purchased and held in its assets, in violation of §83, Title 12, U. S. C. A., shares of its own capital stock. To enable it to own the stock without the national bank examiners discovering that fact, it entered into an arrangement with Greaney, a director, by which he made a pretended purchase of the stock, executing and delivering to the bank his note for the purchase price with the understanding that the stock should at all times continue the property of the bank and that he should never be required to pay the note. Upon failure of the bank, its receiver brought suit against Greaney on the note. Greaney's answer set up the illegal arrangement above referred to and relied specifically upon the bank's agreement that he would not be required to pay the note. It is perfectly apparent that in that case Greaney was trying to enforce a contract made by the bank in violation of law and necessarily *ultra vires.* There, of course, this Court held:

> "If respondent were free to set up the unlawful agreement as a defense and thus cast the loss from the unlawful stock purchase on the creditors of the bank in receivership, he would be enabled to defeat the purpose of the statute by taking advantage of an agreement which it condemns as unlawful. That we think the law does not allow."

Tway occupies no such position as did Greaney. He did not connive with the bank to commit a fraud upon creditors or to conceal a violation of the law. In-

stead of participating in the commission of a fraud, as was true of Greaney, Tway was the victim of fraud on the part of the bank. The case of *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation* involved a substantially similar arrangement as was condemned in *Deitrick* v. *Greaney.*

6.

Refusal of the Trial Court to Hold That Tway Could Not Plead Fraud as a Complete Defense to the Note.

The contention of the Receiver is that in this action Tway's only remedy was to assert the fraud practiced upon him in a counterclaim for damages, offsetting any damages he may have recovered against judgment on the note. He has persistently refused to recognize the fact that Tway was not the plaintiff in this proceeding. Tway's position is that of one resisting the collection of an instrument claimed to have been procured through fraud. The applicable law is perfectly plain. *Williston on Contracts,* Volume 5, page 4269, Section 1525, states:

> "The alternative remedy of rescission and restitution is in its origin equitable, though now similar relief can generally be obtained at law. If the defrauded party has parted with nothing but has merely entered into an executory obligation by simple contract, it needs no citation of cases to establish the point that he may plead the fraud as a defense * * *.

> "If the defrauded party has parted with property which he wishes to regain, he is compelled to become an actor."

Corpus Juris Secundum, Volume 10, page 1091, Section 496, states the rule in this language:

> "As between the original parties to a bill or note, or as against one who is not a holder in due course for value, fraud in the consideration or in the procurement of the bill or note is ordinarily a defense."

In *American Jurisprudence,* Volume 8, page 292, Section 587, it is stated:

> "Fraud in the inception of an instrument is a defense against a holder unless he is protected as a holder in due course or by the operation of an estoppel."

The same work, Volume 24, page 28, Section 204, under the heading "Fraud as Defense," states:

> "Under the modern law, at least in most jurisdictions, fraud in the inducement or the factum of a transaction or contract, commercial or otherwise, may be established as a defense to a claim prosecuted by the person guilty of fraud. Hence when a fraudulent transaction is sought to be enforced in the courts, the defendant may set up the fraud as either a complete or a partial defense, as the case may be, or else in mitigation of damages, or as a ground for recoupment."

Page on Contracts, Volume 1, page 218, Section 136, states:

"If the contract is executory as to the liability of the defrauded party, he may avoid liability thereunder, and interpose the defense of fraud in an action brought against him on the contract at law. This is, in one sense, informal rescission since no decree in equity is necessary. It differs, however, from what is ordinarily termed informal rescission in that the injured party is not seeking to recover what he has parted with under the contract, but is seeking to avoid further liability thereunder."

6 *Ruling Case Law*, 637:

"Since a contract induced by fraud is voidable, the defrauded party may elect to rescind the contract upon the discovery of the fraud. The injured party may, moreover, resist the enforcement of the contract not only in a court of equity but in a court of law. The defense of fraud may be made when a third party, for whose benefit a contract was made, seeks to enforce it. The fact that the contract is in writing does not preclude the introduction of evidence to show that a material stipulation therein was founded on the misrepresentations and fraud of one of the parties. There is no rule of law precluding the defendant, in an action on a written contract, from pleading and proving fraudulent representations of the other party on which he has relied to his prejudice as inducement for the making of the contract sued on. This is the ordinary defense of fraud, which may be interposed in an action at law by way of defense to recovery on a written contract."

Prior to the enactment, in 1915, of Section 274(b) of the Judicial Code (Sec. 398, Title 28, U. S. C. A.), it was generally held by federal courts that the plea of fraud in the procurement of a written contract under seal or a contract in the nature of a specialty was not available to the defrauded party when sued thereon at common law, inasmuch as such a plea was an equitable one. *Burns* v. *Scott,* 117 U. S. 582; *Northern Pacific R. R. Co.* v. *Payne,* 119 U. S. 561; *George* v. *Tate,* 102 U. S. 564; *Whitcomb* v. *Shultz,* 223 Fed. 268 (2d Cir.). The usual remedy resorted to was to file a bill in equity to enjoin the further prosecution of the common law action on the written instrument, as was done in the case of *Salters* v. *Williams,* 244 Fed. 126 (3d Cir.). However, in an action at law in a federal court to enforce a simple contract, the defense of fraud in its procurement has always been available to the injured party. Section 274(b) of the Judicial Code in part provides:

> "In all actions at law equitable defenses may be interposed by answer, plea or replication without the necessity of filing a bill on the equity side of the court."

And that section of the Code has been carried into the new Federal Rules of Civil Procedure as Rule 8 (e) (2), which in part reads:

> "A party may also state as many separate claims or defenses as he has, regardless of consistency or whether based on legal or on equitable grounds or on both."

Enelow v. *N. Y. Life Ins. Co.*, 293 U. S. 379; *Adamos* v. *N. Y. Life Ins. Co.*, 293 U. S. 386; *Burroughs Adding Machine Co.* v. *Scandanavian American Bank*, 239 Fed. 179 (District Court of Washington); *Williams* v. *Green*, 23 Fed. 2d 796 (4th Cir.); *Neff & Fry Co.* v. *Ashmead*, 36 Fed. 2d 771 (2d Cir.); and *Seward* v. *South Florida Securities, Inc.*, 96 Fed. 2d 964 (5th Cir.), were each actions at law, and in each case it was held that the defense of fraud was available to the defendant.

Under Kentucky law, the defense of fraud in the procurement of a contract has always been available when the defrauded party is sued in an action at law on such contract. *Ross* v. *Braydon*, 2 Dana, 161; *Childers* v. *Billiter*, 144 Ky. 53, 137 S. W. 795; *Stephens* v. *Bailey*, 228 Ky. 436, 15 S. W. 2d 263; *Bernhard* v. *Commercial Security Co.*, 185 Ky. 357, 215 S. W. 84; *Kentucky Central Life & Accident Ins. Co.* v. *Edmonson*, 218 Ky. 825, 292 S. W. 511.

The rule laid down in those Kentucky cases would be controlling in this case even though Section 274(b) of the Judicial Code had never been enacted. As there is no controlling federal statute to the contrary, the Receiver, in enforcing the claims of the bank, may do so only in conformity to the law of the forum governing the recovery of debts of like nature. *Pufahl* v. *Estate of Parks*, 299 U. S. 217, 225; *Rawlings, Receiver*, v. *Ray*, 312 U. S. 96, 99.

The rule established by the foregoing authorities applies with equal force in suits brought by receivers of national banks, although counsel for the Receiver

strenuously contended to the contrary in the lower court. Federal courts have repeatedly declared that a receiver of a national bank takes over the assets of the bank as a trustee for creditors, and, in the absence of a statute to the contrary, subject to all the claims and defenses which might have been interposed against the bank when it was a going concern. The cases on this subject will be found collected under Note 41 of Section 192, Title 12, U. S. C. A.

In *Scott* v. *Armstrong,* 146 U. S. 499, this Court said:

> "The receiver took the assets of the Fidelity Bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached."

As there is no federal statute denying the right to plead fraud as a defense in a suit by the receiver of a national bank on a note constituting a part of the assets of an insolvent bank, Tway was clearly within his rights in interposing such a plea.

The petition comments on the fact that Tway did not tender to the Receiver either the Banco stock or the $1,600 of dividends paid on same, as if such tender were a condition precedent to his right to plead fraud. The record shows that at the time Tway discovered the fraud practiced upon him, and at the time he filed his answer, the stock was worthless, and furthermore was

in the actual possession of the Receiver with full power to dispose of same. He had paid on the note a total of $10,883.33, $5,883.33 of that amount being interest and $5,000 payment on principal (R. 107).

Where the defrauded party has suffered by the fraud complained of a greater loss than the consideration which he retains, restoration is not required. *Williston on Contracts,* Volume 5, Sec. 1530; *Page Belting Co.* v. *F. H. Prince & Co.,* 77 N. H. 309, 91 Atl. 961; *Taylor* v. *Lounsbury-Soule Co.,* 137 Atl. 159 (Conn.).

The Alleged Inconsistency of Tway's Position in the Case at Bar With His Position in the Case of Anderson, Receiver, v. Abbott, Et Al.

The Receiver's brief (51) in support of his petition asserts that Tway's position in the case at bar is inconsistent with his position in the case of *Anderson, Receiver,* v. *Abbott, et al.* This contention is based upon what the Receiver contends are irreconcilable allegations in Tway's answers in the two cases. Paragraph XII of the bill of complaint in the Abbott case alleged in substance that BancoKentucky Company was organized by the bank and its stockholders for the purpose of enabling the stockholders of the newly organized institution to enjoy all the advantages and benefits of stockholders of a national bank without incurring the double liability to which national bank stockholders were liable under the national banking law. Strictly in answer to that paragraph, the answer of the defendants in that case in part stated (Abbott, R. 89):

"In regard to Paragraph XII, pages 6 and 7 of the Bill, defendant denies * * * that said BancoKentucky Company was organized as a holding company, or as the agency or the instrumentality for the use of enrichment or furtherance of a scheme to engage in unlawful acts to enable the trustees to unlawfully acquire any property whatsoever, or in defiance of the meaning, or spirit or intent of the laws of the United States or the Commonwealth of Kentucky, or any other state, relating to the ownership or operation or supervision of banks or trust companies. The defendant denies that the BancoKentucky Company was organized by any one as an agency or instrumentality, or for any other purpose, than as a bona fide corporation to conduct the business provided for in its Charter."

The purpose of the *Abbott* suit was to have Banco stockholders adjudged stockholders of the National Bank of Kentucky, and subject to stockholder double liability as such. In that suit the question of whether or not Tway was induced to become a stockholder of Banco by fraud practiced upon him by the bank was wholly immaterial, as it is well settled that when a stockholder of an insolvent national bank is sued by the receiver of that institution to collect an assessment made under the double liability statute, he cannot make the defense that he was induced by fraud to become a stockholder. *Scott* v. *DeWeese,* 181 U. S. 202; *Lantry* v. *Wallace,* 182 U. S. 536; *Whitney* v. *Butler,* 118 U. S. 655; *Robertson* v. *Conway,* 188 Fed. 579 (6th Cir.); *Anderson* v. *Cronkleton,* 32 Fed. 2d 170 (8th Cir.);

Ryan v. *Mt. Vernon National Bank,* 224 Fed. 429 (2d Cir.); *Page* v. *Jones,* 7 Fed. 2d 541 (8th Cir.); *Wilcox* v. *Harriman Securities Corp.,* 10 Fed. Supp. 535.

Furthermore, in the *Abbott* case, notwithstanding the allegations of the petition, the motives which prompted the organization of Banco were of no materiality whatever, and this Court so held. *Anderson, Receiver,* v. *Abbott, et al.,* 321 U. S. 349. At page 357 of the opinion in that case, this Court said:

> "Thus it is no bar to the present suit that Banco was organized in good faith, that there was no fraudulent intent, that Banco was not a sham, that it was not a mere holding company, or that the shareholders of the Bank had no purpose of avoiding double liability. We are not concerned with any question of good intention. The question is whether the parties did what they intended to do and whether what they did contravened the policy of the law."

Now, in the case at bar, it was alleged in Paragraph II of the answer (R. 21) that among the purposes which the bank had in mind in the organization of Banco was to have the newly organized company use its assets for taking sour assets which had been criticized by the Comptroller and the national bank examiners out of the National Bank of Kentucky, and the answer pleaded that this fact, as well as other material facts, were not disclosed to Tway at the time the bank sold the Banco stock to him. It is apparent, therefore, that this allegation was a material one in the case at bar.

It is settled law that allegations of fact made by a party in a pleading in a prior action, which are not necessary or pertinent to a correct decision of that case, do not preclude the party making such allegations from proving those facts in a subsequent action between the same parties when proof thereof is essential to a correct decision of the second case.

The fact that the Circuit Court of Appeals in the *Abbott* case found, as this Court stated:

> "that Banco was organized in good faith and was not a sham; that it was not organized for a fraudulent purpose or to conceal enterprises conducted for the benefit of the Bank;"

does not alter the situation. Such finding does not have the effect of an estoppel by judgment. For a judgment in a prior suit to be conclusive upon the same parties in a subsequent suit,

> "it must appear by the record of the prior suit that the particular matter sought to be concluded was necessarily tried or determined,—that is, that the verdict in the suit could not have been rendered without deciding that matter; or it must be shown by extrinsic evidence, consistent with the record, that the verdict and judgment necessarily involved the consideration and determination of the matter." *Russell* v. *Place,* 94 U. S. 606, 608.
>
> "In other words, to determine the effect of a former judgment pleaded as an estoppel, two questions must be answered: (1) Was the former judgment rendered on the same cause of action? (2) If not, was some matter litigated in the former suit determinative of the matter in controversy in the second suit? To answer these questions we

> must look to the pleadings making the issues, and examine the record to determine the questions essential to the decision of the former controversy." *United States Shoe Machinery Corp.* v. *United States,* 258 U. S. 451, 459.

See also, *Cromwell* v. *County of Sack,* 94 U. S. 351, 352.

It is submitted, therefore, that neither Tway's answer, nor the decision of the Court, in the *Abbott* case is conclusive against Tway to any extent in the case at bar.

The claim of inconsistency leveled against Tway comes with very poor grace from the Receiver whose position in the case at bar in respect of the probative effect and value of the national bank examiners' reports and other documents, and of the condition of the bank is diametrically opposed to his position in respect of those same matters in the *Abbott* case.

We commend to his consideration this language in the greatest sermon ever preached:

> "And why beholdest thou the mote that is in thy brother's eye, but considerest not the beam that is in thine own eye? * * *
>
> "Thou hypocrite, first cast out the beam out of thine own eye; and then shalt thou see clearly to cast out the mote out of thy brother's eye."

Respectfully submitted,

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No. 885

Supreme Court of the United States

OCTOBER TERM, 1944

A. M. ANDERSON, Receiver of the National Bank of Kentucky of Louisville,

Petitioner,

v.

R. C. TWAY,

Respondent.

REPLY BRIEF

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REPLY BRIEF

The response of Tway to the petition amounts to a confession that the "questions presented" are correctly stated in the petition. The response is an attempt to excuse the departure by the courts below from the accepted and usual course of judicial proceedings and to justify the denial of "due process" and cross-examination. The response admits that there was no sworn evidence of the alleged fraud —admits that no witness took the stand with respect thereto—admits that the unverified papers on which the "proof" of fraud rests contained much second-hand, hearsay and incompetent evidence—admits that the right of cross-examination was denied the plaintiff—admits that Tway falsely swore that he owned the stock, whereas the Coal Sales Company was "the real owner of the stock" (see

his Response Brief, pp. 6, 37)—admits that the alleged sale of Banco stock by the bank was ultra vires. Nor does the response deny that the case at bar is a test or class case upon which many similar cases depend.

No excuse is offered for the departure from the accepted course of judicial proceedings and the denial of Constitutional rights in the court below, except that the Receiver, in two previous cases, had introduced in evidence and relied upon, the bank examiners' reports. The two cases referred to were (1) the suit by the Receiver against the bank directors to recover damages for their alleged negligence and violation of statutory duties,[1] and (2) the suit of the Receiver against the shareholders of BancoKentucky to recover their proportionate liability for assessment on the bank stock held by Banco.[2]

In both of these cases, the Receiver offered in evidence the bank examiners' reports. However, in both of these cases, the reports were offered in evidence in accordance with the accepted and usual course of judicial proceedings and the Constitutional rights of the defendants in both of these cases were fully protected. In both of these cases, the trial court required that the bank examiners who prepared the report be sworn, placed upon the witness stand and examined as to his sources of information and also that he submit to cross-examination. In the suit to establish directors' liability, the examiners personally appeared and the record shows lengthy examination and cross-examination.[3] Likewise in the suit to establish stockhold-

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[1] *Atherton* v. *Anderson*, 86 F. (2d) 518; 302 U. S. 643; 99 F. (2d) 883.

[2] *Anderson* v. *Abbott*, 321 U. S. 349.

[3] In the transcript of record, Vol. II, Narrative Bill of Evidence, Vol. I, No. 12, Oct. Term, 1937, Supreme Court of the United States, Examiner Vance L. Sailor testified under direct examination, p. 483; under cross-examination, p. 485. Robert Neill testified under direct examination, p. 487; cross-examination, p. 499; re-examination, p. 507; recross-examination, p. 508; recalled in rebuttal, p. 510. Examiner John S. Wood, direct examination, p. 514; cross-examination, p. 524; re-examination, p. 552. Examiner Stewart H. Mann testified direct examination, p. 553.

ers' liability, the trial court refused to admit the bank examiners' reports until the bank examiners were each sworn as witnesses and testified concerning their reports. Thus fact was separated from hearsay and direct evidence from second-hand and incompetent information, which the examiners could not "guarantee."[4]

Both the directors' and the stockholders' liability cases were equity proceedings tried before a judge, without a jury. The present case was an action at law tried before a jury who were not capable of separating the wheat from the chaff, and who were instructed by the court that they could predicate their verdict upon the hearsay and second-hand information contained in the examiners' reports.

Tway based his principal claim of alleged fraud on the assertion (which covers 23 pages of his answer) that Banco was formed for the specific purpose of removing bad assets from the bank and taking them into the portfolio of Banco. This evil and fraudulent purpose was stressed in the argument of his counsel to the jury (R. 1387) and was the basis of the jury verdict. Moreover, in both of the cases in which the Receiver introduced the bank examiners' reports the court found affirmatively, and as a result of direct and cross-examination, that Banco was not organized to take bad assets out of the bank and had no such evil and fraudulent purpose. This demonstrates that when the accepted course of judicial procedure is followed, the court could and did disregard incompetent and unsupported hearsay and made findings directly contrary to the verdict of the jury in the present case, which was based solely on hearsay.[5]

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[4] Record No. 3, Oct. Term, 1943, Supreme Court of the United States, Examiner Robert Neill, direct examination, pp. 140-153; cross-examination, pp. 153-159; recalled for further direct examination, pp. 159-166; recross-examination, p. 166. Examiner Russell Mooney, p. 167. Examiner John S. Wood, direct examination, pp. 169-182; cross-examination, p. 182.

[5] In the directors' liability case, *Atherton* v. *Anderson*, 86 F. (2d) 518, 537, the court said: "The BancoKentucky Company was certainly not a

Counsel for Tway recognized in the Court of Appeals that the trial court's departure from the constitutional safeguards of due process could not be defended and, therefore, endeavored in that court to withdraw any reliance upon the alleged sinister and fraudulent purpose of Banco. We quote from the Court of Appeals' opinion in the present case:

> "Tway now contends that he did not rely upon the allegation that Banco was organized for the purpose of removing bad assets from the bank. That issue was, however, submitted to the jury and there can be no doubt that the evidence bearing thereon was prejudicial." (R. 1365.)[6]

In this court he has again reversed his position and reverts to the claim made in the lower court. (See his Response to Petition, p. 54.)[7] Hence questions 1 and 2 set forth in the petition for certiorari are squarely presented

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sham . . . nor was it organized for a fraudulent purpose or to conceal secret or sinister enterprise conducted for the benefit of the bank."

In the stockholders' suit, *Anderson* v. *Abbott*, the court found "Banco was organized in good faith. Banco was 'certainly not a sham.' Banco was 'not organized for a fraudulent purpose or to conceal secret or sinister enterprise conducted for the benefit of the bank.' Banco 'was formed for the purpose set out in the letter of July 19, 1929, and for no other purpose.'" (R. No. 3, October Term, 1943, Volume 1, p. 267.)

In connection with the finding of fact that Banco was formed for the purpose set out in the letter of July 19, 1929, and for no other purpose, compare Tway's answer, where he says that that letter "does not set forth, but was in truth and fact the reason why the bank organized that company." (R. 16.) ". . . The BancoKentucky Company was organized by the bank for the purpose of procuring this defendant and others to subscribe for stock of the BancoKentucky Company and to pay for same in cash in order that the bank, being in control of said BancoKentucky Company, might take the funds of the BancoKentucky Company for worthless claims carried by the bank amongst its assets." (R. 21.)

[6] When that issue was submitted to the jury, the District Judge instructed them that the only evidence tending to establish this claim was the observation in the bank examiners' reports. (R. 1217.)

[7] "Now in the case at bar it was alleged in paragraph 2 of the answer (R. 21) that among the purposes which the bank had in mind in the organization of Banco was to have the newly-organized company use its assets for taking sour assets, which had been criticized by the Comptroller and the national bank examiners, out of the National Bank of Kentucky, and the answer pleaded that this fact, as well as other material facts, were not disclosed to Tway at the time the bank sold the Banco stock to him. *It is apparent, therefore, that this allegation was a material one in the case at bar.*"

and the excuse that the Receiver relied upon bank examiners' reports in two previous cases after the Examiner was sworn and duly examined, shows no inconsistency in the position of Receiver but proves the necessity for following constitutional safeguards and requiring both sworn evidence and cross-examination.

In the response brief, Tway quotes from the brief the Receiver filed in the stockholders' suit, where references were made to the examiners' reports. (Response brief, pp. 12-16.) Consideration of the passages quoted will show that such references were made to establish the condition of the bank. The Receiver has consistently claimed that the bank's financial condition was shown in the examiners' reports. This is a far different question from the one here presented, which is an attempt to use the examiners' reports, without calling the examiners, to show that Banco was organized for a secret and fraudulent purpose. The condition of the bank was taken from the books of the bank, which were the subject of examination. The statement in the report, from which the deduction was drawn that the purpose of Banco was to remove "sour" and "bad" assets from the bank, was pure hearsay from an unidentified source and comes clearly within the boundaries of the preliminary statement of the examiner, that he was "not in a position to guarantee the accuracy of such part of the information."

RECENT DECISION OF TENTH CIRCUIT COURT OF APPEALS SUPPORTS OUR POSITION ON QUESTIONS 1 AND 2, AND IS IN CONFLICT WITH THE DECISION OF THE PRESENT CASE

Since filing petition for a writ of certiorari in the above case the decision and opinion of the Tenth Circuit Court of Appeals in *Franklin et al.* v. *Skelly Oil Company,* 141 F. (2d) 568, March 10, 1944, has come to our attention.

This decision is in direct conflict with the decision in the present case on questions one and two set forth in our petition for writ of certiorari.

Franklin v. *Skelly Oil Company,* supra, was a damage suit for negligence. The court excluded an *official "report by a public officer acting in pursuance of his statutory duty."* Appellant contended this was error. The Court of Appeals held that the report should have been excluded. In so holding the court said:

> "*But expressions of opinion and conclusions on causes and effects based upon factual findings are not always admissible as public records, especially when it is shown either that the conclusion or opinion which the statement purports to convey would not be admissible in evidence if tendered by the direct testimony of the maker, or if the denial of the right of cross-examination would result in the perversion of the rule of trustworthiness and reliability.* See *Kansas City Life Ins. Co.* v. *Meador,* 186 Okl. 397, 98 P. (2d) 20. The search is for truth and the trial court is the first and best judge of whether tendered evidence meets that standard of trustworthiness and reliability which will entitle it to stand as evidence of an issuable fact, absent the test of cross-examination.
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> "Here the written statement of the inspector was offered for the purpose of proving the primary issue of negligence in a private lawsuit, and upon its face it stated the bare opinion of the officer who made it. By its peculiar character and the circumstances under which it was offered, the trial court was justified in the exercise of his discretion not to admit it ex parte. The statement is not admissible because of its lack of authenticity or because it is not a public document subject to public inspection, but because the matter and things contained therein express merely the opinion of one whose official office and duty does not rise to the dignity of an adjudicator of causes and effects."

In the case at bar the trial court admitted hearsay statements contained in examiner's reports, the accuracy of which the examiner affirmatively stated could not be guaranteed since they were not obtained at first hand. The answer to the question on pages 29-30 of the Response Brief is that such statements would not be admissible in evidence if made during the course of direct testimony had the examiner been called to the witness stand. The Tenth Circuit holds that such hearsay statements contained in official reports should not be admitted and that their admission would result in a "*denial of a right of cross-examination*" and "*in the perversion of the rule of trutworthiness and reliability.*" As this court said in *Alford* v. *United States,* 282 U. S. 687, 691:

> "In this respect a summary denial of the right of cross-examination *is distinguishable from the erroneous admission of harmless testimony.*"

We submit that the important question of the introduction of hearsay in official reports without calling the official responsible therefor as a witness, without cross-examination and without verification, and the conflict of decision thereon should be resolved by this court.

ADMISSION OF UNVERIFIED BILL

The "response" seeks to minimize the gravity of admitting the unverified bill in equity of the Receiver against the directors. The entire bill in equity was introduced in evidence by Tway and his counsel read to the jury the portions thereof making certain *claims* with respect to the organization of BancoKentucky. These claims were largely held to be incorrect upon the subsequent trial of the case. Nevertheless, these disproved *claims* made in an unverified bill went to the jury as *uncontradictable proof of facts.*

The attempt of the Receiver to show that the claims had been disproved by offering the final opinions and findings in the directors' liability case was denied (R. 1095, 1172). The attempt in the "response" to justify this departure from "due process" has no substance. The cases cited to justify the admission of unverified claims are state cases contrary to the Federal authorities and to the rule in Kentucky. The Kentucky cases and the three Federal cases mentioned on pages 33 and 34 are not cases which involved introduction of unverified pleadings. The Receiver by presenting *claims*, did not make "admissions." The Receiver had no personal knowledge of the facts. The court decided that the claims made were not established. It would be strange, indeed, if the claims of the bill in equity against the directors on which the Receiver was not able to recover after an elaborate trial, should now become unimpeachable proof of unproved charges. Respondent has no answer to the statement of Judge Simons in the opinion below, to wit:

> "Since the opinion in *Atherton* v. *Anderson*, supra, was an adjudication that there was no fraudulent intent in the organization of Banco, the Receiver should have been permitted, by means of it, to demonstrate the error in the allegations of his pleading." (R. 1364.)

The question is not merely as to the erroneous admission and exclusion of evidence. When the court held that the claims in the bill of equity were not rebuttable, the Receiver was denied the opportunity to produce his proof. This constitutes a denial of "due process."

CONCLUSION

Tway was a party-defendant in *Anderson* v. *Abbott*, in which his assessment liability was determined. In that case, he was successful in having the courts hold "that Banco was organized in good faith,"—"that it was not organized for a fraudulent purpose or to conceal enterprises conducted for the benefit of the bank." This court accepted those findings "as they were concurred in by two courts and no clear error is shown." In the present case, in an effort to avoid liability on his note, he successfully induced a jury to hold diametrically opposite on the basis of *unverified hearsay* in examiners' reports and *unsworn claims* in a bill in equity, which were judicially disproved. The findings of the court in the *Abbott* case in which Tway was a party-defendant and an appellee in this court, should have been accepted by the courts below as a final determination of the issue and binding upon him in all subsequent trials of the same issue. *Southern Pacific R. R.* v. *U. S.*, 168 U. S. 1; *Oklahoma* v. *Texas*, 256 U. S. 70.

The questions presented in this case and which will necessarily arise in each of the cases against other borrowers from the bank which are awaiting trial pending the final decision of this case, are of general importance. Similar questions are arising and will continue to arise in connection with the use of official reports as conclusive proof of hearsay statements contained therein. The importance of the questions is not denied by respondent.

Respectfully submitted,

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